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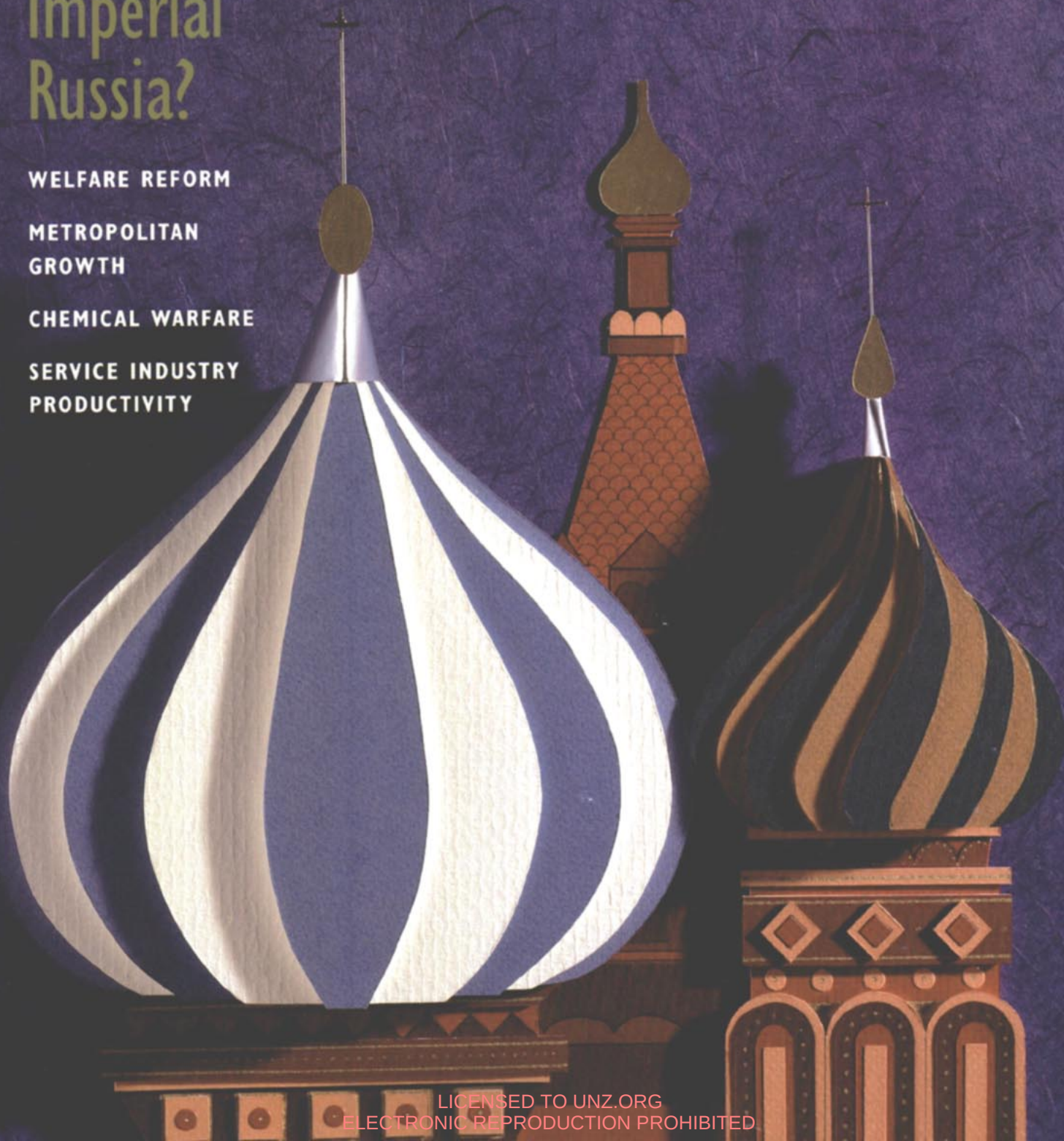
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On Foreign Entanglements

■ In April 1993, 79 percent of the American public (in a *Times Mirror* poll) said, "We should not think so much in international terms but concentrate more on our own national problems." A month later, 87 percent agreed that "It's best for the future of our country to be active in world affairs." Observers outside the United States never quite know which extreme will prevail at any time, or in any particular crisis spot. And so they worry, either about incipient isolationism or about nationalistic interventionism.

Catherine Kelleher's "Soldiering On" (spring issue) should put most worriers a bit more at ease. Between its two extreme views, the American public seems to arrange itself into a fairly predictable pattern of international involvement that can be rather cautious at one time, mildly aggressive at another, but never fully isolationist or totally unilateral. In fact, she might have made her argument even stronger. Public support for the use of military power was never as strong during the Cold War as she implies (witness the pressure for withdrawal from such places as Korea, Vietnam, and Lebanon), nor is it as weak as it now seems after Somalia. For better or worse, support for the judicious use of military power appears fairly strong, throughout the Cold War years and beyond.

*Gebhard Schweigler, Stiftung
Wissenschaft und Politik*

Peacekeeping, Yes.

■ Catherine M. Kelleher's essay ("Soldiering On," spring issue) on how the American public views the use of military force is largely consistent with the polling data we have analyzed at the Program on International Policy Attitudes (PIPA), but I want to counter one point.

While the experience in

Somalia was traumatic for the American public, it does not seem that Americans' negative feelings have generalized to UN peacekeeping per se. Kelleher speaks of a growing "disillusionment with . . . the concept of peacekeeping in general." But a February 1994 PIPA poll found that an overwhelming majority (84 percent) support UN peacekeeping in principle. And even regarding Somalia, polls by CBS News have shown that more than 60 percent still think the United States did the "right thing" by going into Somalia in the first place.

Steven Kull, PIPA

Long-Term Care Insurance Is Not Irrelevant

■ Joshua Wiener and Laurel Hixon Illston ("How to Share the Burden," spring issue) make a passing reference to a "public-private" partnership for long-term care financing, but then dismiss private insurance as an irrelevant option for most older Americans, instead advocating a government-run universal entitlement program for home and community-based long-term care services. But the insurance policy they model costs more than twice the typical policy actually sold in the marketplace (to more than 2 million rational elderly purchasers, we might add). The typical policy covers 5 years of nursing home care at \$70 a day with one-third having inflation protection; average premiums are \$1,200 a year, not the more than \$2,500 suggested by the authors. If the federal government offered such a program, Wiener and Illston would probably not view it as inadequate.

While its welfare status contributes to its problems, most of Medicaid's drawbacks spring from the absence of uniform national eligibility criteria (with no minimum set of benefits defined), which means that Medicaid is implemented differ-

ently across states. One can improve Medicaid without having to provide benefits to rich and poor alike. It is wiser to target scarce federal dollars on those who cannot afford to care for themselves or who cannot pay for private alternatives.

*Marc A. Cohen and A.K.
Nanda Kumar, LifePlans, Inc.*

Preserving Medicine's Social Contract

■ Describing the almost palpable tension between cost cutters' efficiency goals and medicine's aspirations to provide everyone the best care possible, Samuel Hellman ("Fin de Siècle Medicine," spring issue) suggests that the "social contract" between society and medicine is changing. Perhaps. But society may simply be demanding that the health care system live up to its part of the contract—that is, to deliver affordable, high-quality health care for all.

Poll after poll has shown that what concerns Americans most about health system reform is that the quality of their care will be reduced by new constraints on their choice of provider, by the rationing of health care services, and by a change in the doctor-patient relationship—from one in which the doctor is first and foremost the patient's loyal advocate to one in which the doctor's loyalty may be compromised by competing obligations to organizations and shareholders concerned with the bottom line.

These concerns reflect a profound commitment to the social contract between physicians and patients. Our job is to assure that reforms uphold and strengthen it.

*Michael E. Johns, Johns
Hopkins School of Medicine*

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GATT: Where the Real Money Is

BY BILL FRENZEL

The congressional ratification of the North American Free Trade Agreement has been called the most important vote on Capitol Hill since the Berlin Wall came down.

It gave President Clinton the most significant policy success of his first year. It established his international economic credentials and made him the unquestioned leader in the Asia Pacific Economic Cooperation meeting last fall. It proved U.S. *bona fides* in hemispheric relations. And it probably was the lever that moved the Uruguay Round of the General Agreement on Tariffs and Trade (GATT) to completion last December.

But for all that, NAFTA is an economic sideshow. Its vaunted 200,000 jobs are far better than not having 200,000 jobs, but California's defense industry alone lost more jobs than that in a single year. NAFTA's economic stimulus is far better than none at all, but it amounts to growth of only a handful of basis points in GDP.

The real money is in the Uruguay Round. Willie Sutton, who always went where the money is, would have loved the GATT. The Uruguay Round of trade liberalization means percentage points, not basis points, of U.S. GDP growth. It means trillions of dollars in increased world trade.

The NAFTA momentum and a relative absence of enemies made GATT ratification look like a cinch last December. But soon after the final version was signed in Marrakesh in April, the euphoria began to fade.

GATT's troubles are, for the most part, not the same as those that plagued NAFTA until the president's come-from-behind victory last November. Although NAFTA was hounded for a year by bad publicity, the media attention accorded GATT has been generally

positive. Ross Perot is not an irritant. The sucking sound is gone. The AFL and its friends like GATT no better than NAFTA, but now have other priorities, like health care.

One problem GATT does share with NAFTA is the federal budget. Under congressional rules, reductions in taxes (tariff duties) must be offset by new revenues or by reductions in entitlement spending. For NAFTA, this was a measly \$2 billion. For GATT, it is a whopping \$14 billion.

And GATT has a problem common to all trade treaties. It needs strong, well-articulated, comprehensive business support. Congress will usually listen to business on trade, but only if it shouts. And beginning last April, business had other priorities too. With China's most favored nation trade status under strong challenge from the president himself, the time and resources of major businesses were being devoted heavily to the China problem. China is on the agenda ahead of GATT, and it is getting all the attention.

In addition, several important business sectors did not achieve their full aspirations in the GATT agreement. They may ultimately support the treaty, but in May some were still sulking, others noncommittal.

Even the calendar has begun to be a problem. Health care, welfare reform, and crime are thought to be important on Capitol Hill, and time is also needed to work on appropriations. Then too, Congress does not feel wholly comfortable slugging it out on GATT before the fall elections. Friend and foe alike have begun suggesting that next year will be soon enough.

Fearing the phase-out of the Multi-Fiber Agreement, textiles, America's most protected industry, has loosed the specter of loss of sovereignty—a ques-



tion that eventually stalks the halls of Congress in connection with every trade treaty. This time the sovereignty attack centers on a new system of voting in the GATT. In fact, the new voting system is so close to the old that it would take a microscope to find most differences. The only important difference is that the current system permits a country in a trade dispute to veto GATT rulings it deems unfavorable, while the new rules deny such a veto. The change was sought by U.S. negotiators under both Bush and Clinton. They followed the mandate of the 1988 Trade Act so that U.S. actions in GATT to relieve unfair practices could be brought to a conclusion.

The net is that while GATT enjoys broader support than did NAFTA, it is still encumbered with enough baggage that its passage is not assured. As in NAFTA, the administration's problems are not caused by what it has done wrong, but it must move quickly and aggres-

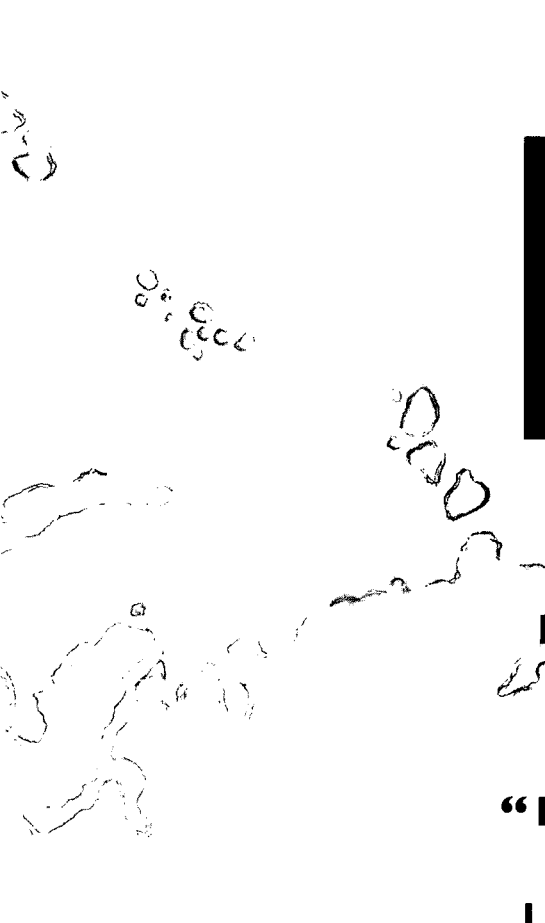
sively to solidify support and move its treaty.

Again, like NAFTA, there is time enough, and support enough, to get the job done. GATT will be another test of the administration's commitment to international economic progress in the face of other attractive and important Clinton goals.

The Uruguay Round of the GATT can be ratified, but the possibility that it will be defeated or carried over to next year is still growing. If President Clinton likes jobs as much as Willie Sutton liked money, his administration will rally to the cause—and will prevail. ■

Bill Frenzel is a guest scholar in the Brookings Governmental Studies program. A member of the U.S. House of Representatives from 1971 to 1991, he is a former Congressional Representative to GATT.





PERILOUS ECONOMIC REFORM AND RUSSIAN “IMPERIALISM” TIES?

J E R R Y F . H O U G H



In recent months, especially since the victory of Vladimir Zhirinovsky's Liberal Democratic Party in the December 1993 Russian elections, many Westerners have expressed alarm about the rebirth of Russian imperialism. There are, indeed, many signs of increasing integration within the Commonwealth of Independent States. But much of the West's anxiety is not a product of close analysis of likely scenarios, let alone of its long-term security interests. Rather it is a reflex reaction from the past.

Why is a word such as “empire” used so freely when more contemporary alternatives, such as common market, confederation, economic union, bloc, or federation, are not even considered? After all, the United States favors the economic integration of North America and does not call NAFTA an empire. Is it possible that we are overlooking, in the case of the former Soviet Union, a necessary relation between economic reform and economic integration?

Jerry F. Hough, James B. Duke Professor of Political Science at Duke University, is a nonresident senior fellow in the Brookings Foreign Policy Studies program. He is completing a book on the relationship between democratization and economic reform in Russia.

Economic Reform and the Union

Russian politicians who want gradual economic reform, an emphasis on industrial production rather than on macroeconomic policy alone, the Chinese economic model—however they phrase it—invariably want closer economic ties with the former Soviet republics. Their preference is not the result of some psychological link between “conservative” economic policy and “imperial nationalism,” but of a logical and necessary connection between the two.

The link between economic reform and the union first emerged clearly in the great debate among Boris Yeltsin’s closest advisers in the late summer and early fall of 1991. One group was headed by Yeltsin’s chief political adviser, Gennadii Burbulis, and included two young economists, Yegor Gaidar and Aleksandr Shokhin. It insisted on the freeing of prices, a tight money policy, a free trade foreign economic policy, and an independent Russia. The other group was headed by Yeltsin’s chief lieutenants in the Sverdlovsk party organization, Oleg Lobov and Yurii Petrov. They argued for moderate economic reform and for a strong economic union with the republics.

As they often acknowledged in private, Gaidar and his associates favored a policy of deindustrialization. They well understood that their shock therapy program would lead to a big drop in industrial production, the closing of many plants, and massive unemployment, but this they saw as a positive good. They knew that the big industrial plants were grossly overstaffed and inefficient

and that they produced too many of the wrong goods—too much steel, too

many large tractors, too many unwanted consumer goods—and not enough of the right ones. The Gaidar

group assumed that gradual change would be too difficult and painful in the long run. Only if managers had to compete desperately for business, only if mass industrial joblessness forced people to work in the service sector to survive, could the economy be

transformed. The shock would be painful, but not as painful as the alternative.

The Lobov-Petrov group, of course, warned that the Gaidar program was politically impossible, that workers and the military would not tolerate a policy so destructive of heavy industry and the defense industry. They also argued that it could not work because of the complete monopolization of the Soviet economy. Soviet planners had so emphasized specialization of production that key supplies were produced in only one or two plants in the country. Hence, in this view, significant capital goods plants, even if inefficient and unprofitable, could not be shut down without having a catastrophic ripple on other industries downstream. Moreover, monopoly producers would not respond to a freeing of prices by becoming more efficient, but by raising prices. To create competing suppliers would take years—and a major government investment program.

Both the Gaidar and Lobov-Petrov economic positions had clear implications for Russian policy toward the Soviet Union and Russian independence. The Soviet ministries had not considered republican boundaries when they carried out their specialization program. Hence closing a plant in Ukraine or Kazakhstan could be as destructive to Russian plants as closing one in Russia. For Lobov and Petrov, an industrial policy at home meant Russian subsidization and investment in other republics, all of which were utterly dependent on heavily subsidized prices for Russian oil, gas, and raw materials.

For precisely the same reasons, the proponents of the Gaidar economic position strongly favored Russian independence. Unwilling to subsidize Russian plants and farms, they had even less reason to subsidize non-Russian enterprises. Willing to destroy supply ties inside Russia, they would hardly worry about cutting supply ties with former union republics. Moreover, the Gaidar policy implied an emphasis on the export of petroleum and other commodities to get hard currency. Sending these commodities to the non-Russian republics at highly subsidized prices would not only expand the deficit (a point usually inaccurately described as allowing the non-Russian republics to create their own rubles), but also leave less petroleum and other commodities to be exported.

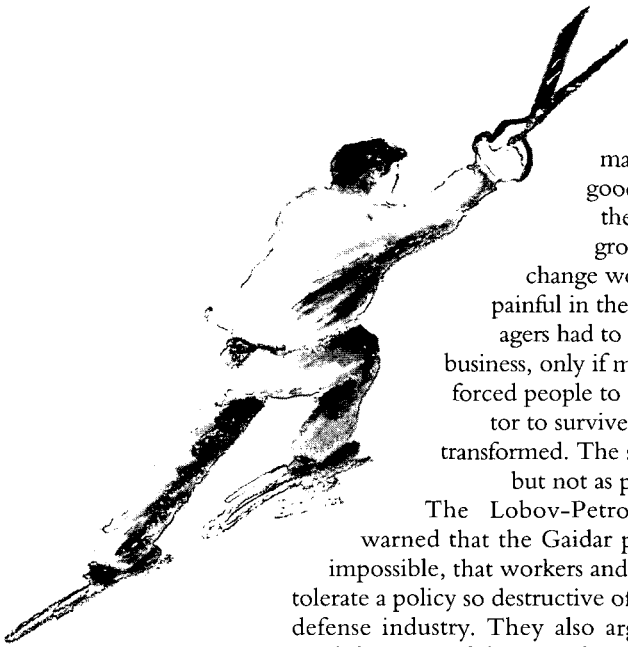
What became clear in 1991 was the link between Russian economic policy and policy toward preserving federation (or confederation). Less clear was the direction of the causation. Perhaps economic interest and ideology drove each side to its position on the union, or perhaps the opposite was true. For some of Yeltsin’s top advisers, the latter is surely the more probable. Mikhail Gorbachev’s term as USSR president extended until 1995, and, as Burbulis reportedly told premier Ivan Silaev, a Lobov ally, “If we have an economic union with the other republics, how can we get rid of Gorbachev?”

Many suspect that Yeltsin believed the Lobov-Petrov contention that the Gaidar plan would destroy the economies of the republics. They think Yeltsin intended, once their economies were destroyed, to reintegrate them under Moscow’s control. The perpetual conflict with Ukraine on the Black Sea Fleet seemed a harbinger of that intention, but all this was merely speculation.

Subsidies and the Paradox of “Empire”

By October 1991 the Burbulis-Gaidar position had won. Burbulis became first deputy premier (de facto premier since Yeltsin assumed the premiership) and Gaidar the deputy premier in charge of the economy. The union broke up, and Russia became independent. Russian industrial production declined—some 50 percent since 1990—and industrial investment dried up. But deindustrialization saw no plant closings and surprisingly little unemployment. The reason was that Yeltsin quickly moved to the basic Lobov-Petrov position on subsidies, although often through off-budget inter-enterprise “loans.” As I described in these pages last year (“On the Road to Paradise Again?”), the ministries were replaced by “privatized” holding companies, corporations, and the like that functioned much as the old ministries had in supply procurement.

The result of the breakup of the Soviet Union was very mixed. Formally, independence meant less than



Westerners thought: even under Stalin the republics were “sovereign.” After 1944 all had ministries of foreign affairs, and Ukraine and Belorussia were members of the United Nations. With the breakup of the union, foreign countries recognized the independence of all the republics, established diplomatic relations with them, and admitted them into the United Nations.

Informally, the Russian Ministry of Foreign Affairs treated the new countries as “the near abroad” and played a minimum role in Russia’s relations with them. A number of important economic and political issues were now determined in the republics, but Russia’s economic ministries and quasi-privatized institutions continued to play a dominant role in the economic life of “the near abroad.” The Russian army remained in its old positions. Battles between militia-like units raged on the southern border of the former Soviet Union from Moldova to the Transcaucasian Republics to Tadzhikistan, but issues were quickly settled whenever the Russian military intervened.

Although Russian subsidies to the former union republics have prevented the total collapse of their economies, the new policy is clearly worse than the old in one respect. In the Soviet Union, subsidies were buried in a maze of nonmarket prices, and their scale was obscure. In practice, the subsidies were a right, for monetary values did not determine the distribution of goods. Now subsidies are more of a grant and privilege, and gifts can be withdrawn.

In fact, when the newly independent countries behave in ways Moscow considers unacceptable, Moscow can and has cut subsidies with devastating impact. Lithuanians suffered this fate before the October 1992 election, in which they showed they were quick learners, replacing their confrontational president with the former Communist first secretary. Conditions in Armenia and Georgia have often been desperate because of Russia’s displeasure at their intervention in ethnic conflicts. Even more often, especially in relations with Ukraine, Moscow has extracted concessions by threatening to increase oil and gas prices or to cut off supply for nonpayment in the midst of political or military negotiations.

In a recent *Foreign Affairs* article warning about Russian imperialism, Zbigniew Brzezinski accurately described Russian economic pressure on Ukraine: “Economic leverage has been applied through reductions and periodic cutoffs in the delivery of vital energy sources to Ukrainian industry, presumably in the hope of destabilizing the country to the point that a sizable portion of the population will begin to clamor for a closer connection with Moscow.”

But what steps does Brzezinski want Russia to take to reassure the United States that its actions do not signal the reemergence of Russian imperialism? He wants them to implement “American prescriptions for democracy and the free market.”

Certainly that has been the American government’s most consistent advice and demand to Russia’s leaders: free market prices, fiscal stringency, and an end to governmental subsidies. Special attention has been given to energy subsidies and especially to market prices for petroleum as a necessary step to force energy conservation and increase the petroleum available for export and the acquisition of hard currency.

The advice was repeated after the December 1993 Russian election by the International Monetary Fund and by President Clinton at last January’s Moscow summit. Premier Viktor Chernomyrdin seems, indeed, to be following that advice by continuing the shock therapy introduced by Yegor Gaidar in September. Wages often are not paid, on a rationale explained by a deputy ministry of economics to CNN on April 17: “If managers reduce the number of workers by 25 percent, they will have the money to pay the others.” Industrial production is down 29 percent in Russia over the past year, and subsidies to Ukraine are naturally being reduced at the same time.

But if, as Brzezinski rightly says, the Russian reduction of economic subsidies has led to a situation in which “Ukraine is on the brink of disaster . . . [with its] economy . . . in a free fall,” then Russian acceptance of the American proposal of free market prices for petroleum and raw materials would long ago have pushed Ukraine over the brink, and the free fall would have ended in total collapse. If American advice were to be accepted, the entire Ukrainian population—not just a sizable portion—would be demanding a closer connection with Moscow.

Perhaps the United States is following a sophisticated, if cynical, policy to achieve this very goal. Perhaps it is so concerned about political stability in Russia and nuclear proliferation in Ukraine that it is pushing an economic policy that it knows will force the reintegration of the Soviet Union. Perhaps it has chosen this path rather than a more direct one because it prefers to be accused of naïvete rather than Machiavellianism.

Perhaps. But not likely. After all, the U.S. officials most influential on Russian policy—those in the Treasury Department—deal regularly with Yegor Gaidar and Boris Fedorov, who honestly believed they could introduce a real shock treatment (including nonpayment of wages to many workers and soldiers and nonpayment for the harvest to the peasants while prices were being raised) last fall and still win the December election. It is hard to imagine that Americans working closely with them would understand Russian and Ukrainian politics any better.

In fact, an agreement on economic union has been signed with Ukraine. A top Yeltsin aide told the *Financial Times* on May 4 that the Russian government cannot tolerate the continuing decline in industrial production and will reverse the policy of Premier Chernomyrdin. The economic and Ukrainian policy are interconnected, and both are inevitable either under President Yeltsin or after he is ousted.

What Should the Clinton Administration Do?

Although Brzezinski is sharply critical of the Clinton administration for ignoring the danger of Russian imperialism and for its fuzzily optimistic “premature partner-

**ONLY IN
RUSSIA DO WE
INSIST ON
“OVERNIGHT”
ECONOMIC
REFORM.**

NO ETERNAL FRIENDS OR ETERNAL ENEMIES, BUT ONLY ETERNAL INTERESTS.

ship” with Russia, in fact a strong case can be made that the policy of both the Bush and Clinton administrations—whether fully realized or not within the Clinton administration—to engage in that partnership is the genuine realpolitik option today.

In the past 40 years or so realism in international relations has become misdefined as a steadfast hard-line policy toward the Soviet Union. Actually, the essence of realist theory was best expressed in the 19th century by Lord Palmerston, “England has no eternal friends or eternal enemies, but only eternal interests.” The realist theory arose to explain and to justify the striking shifts in alliances that took place so often in international relations. The most striking recent example was the shift of the United States from an alliance with the Soviet Union against Germany in the early 1940s to an alliance with Germany against the Soviet Union in the late 1940s.

According to realist theory, the end of the military threat, first from Western Europe after the Second World War and then from the Soviet Union after the Cold War, *should* lead other countries to adjust their foreign policies, perhaps dramatically. The most likely dangerous scenarios involve the rise of fascist regimes—perhaps under nationalist guise, perhaps under religious guise as in Iran—in a large Asian country with nuclear weapons or the ability to build them rapidly.

For 500 years beginning around 1450, Europe was torn apart by repeated wars fought by peoples struggling to define their national identities and the relationship of country borders to them. That same turbulent process has just begun in Asia and Africa. Mass adjustment to the new and frightening (“satanic”) city also continues for millions of new people there each year, and populist leaders in Asia try to exploit them as did such leaders in Europe. Both Russia and the West are responding to that fact.

Soviet Realism

Recognition of this change in the global environment was a crucial factor in the recent transformation of the Soviet Union. As early as 1978, head of the General Staff, Nikolai Ogarkov, wrote with alarm in *Kommunist* that technological backwardness was dangerous for Russia. Both Admiral William Crowe and General Colin Powell found that Ogarkov’s successors, Marshals Sergei Akhromeev and Mikhail Moiseev, understood the military implication of the decline in the threat from Europe and the rise in that from Asia: the Soviet Union must move from confrontation with the West toward greater partnership. By 1986, as I noted at the time in an article in *International Organization*, Mikhail Gorbachev himself was explicitly quoting Lord Palmerston and talking about Europe in a way that clearly implied the unification of Germany.

In an interview in March 1993, then Vice President Aleksandr Rutskoi, who as an air force colonel was captured by the Afghan rebels, expressed a similar view. The danger to Russia, he said explicitly, comes from the Middle East, South Asia, and the Far East. Russia should ally with the United States. Rutskoi favored Western joint ventures even with Russian defense plants. When asked if he did not fear that the United States might use the pretext of interest in investment to spy on the defense plants, he answered, “Russia should be treated as a partner like Germany and Japan after World War II.”

The older generals may not have understood the economic implications of the change in the international scene as well as Rutskoi, but many civilians did. The success of Japan and other Asian countries in the 1970s demonstrated that Lenin had been wrong in arguing that integration into the world economy meant neocolonial exploitation of late-industrializing countries. The growing economic problems of the Soviet Union demonstrated that Western economic theory was right in arguing that total atarky meant total protectionism and that this was disastrous for efficiency and technological innovation. Both a fundamental change in the economic system and a partnership with the West were necessary to ensure full integration into the world economy and an end to atarky.

Past Time for U.S. “New Thinking”

According to realist theory, the United States too should respond to the reduction of the Russian threat and to the same potential threats that are frightening Russia. The 21st-century prospect of Asian superpowers populated by a billion people should prompt Americans and Europeans too to begin to come together—a vision captured by former Secretary of State James Baker’s famous remark about a Europe extending across the Atlantic from Vladivostok to Vancouver.

The Clinton administration has been energetic in dismantling the economic restrictions on investment in Russia (most recently in abolishing the whole COCOM structure that for years forbade Western trade with Warsaw Pact countries in weapons and weapons technology), and it talks about a partnership with that country. But it has so far failed to explain why there should be such a partnership. The Yeltsin government keeps seeking an endorsement of the “Vladivostok to Vancouver” idea, first by insisting on the first summit in 1993 being held in Vancouver and then by raising the question directly at the 1994 Moscow summit. The Clinton administration has refused, even though its explicit endorsement of the Baker formula as evidence of a bipartisan foreign policy would help blunt the force of Republican criticism.

Because there is no imminent danger in Asia and because the Russian domestic political situation is not yet defined, the United States need make no irrevocable decisions at present. But when Mikhail Gorbachev began transforming the Soviet Union, his first step was to try to change public understanding, to introduce “new thinking.” It is past time for such an effort in the United States today.

Two messages are essential. The first is that events from Yugoslavia to South Africa to Kashmir to Sri Lanka

indicate that the process of sorting out ethnic identity and national boundaries is going to be as explosive in Asia and Africa as it was in Western Europe. The great powers, including Russia, should be cooperating to try to prevent explosions, for far larger countries than Bosnia or Lebanon can explode—and far more dangerously. A supreme and conscious effort should be made to make Bosnia the symbol of such cooperation.

The second message is that national self-determination in the prewar sense is not the solution. The problem with Bosnia and Ukraine as fully independent countries is that they themselves are as multi-ethnic as Yugoslavia and the Soviet Union. Once Bosnian and Ukrainian leaders insist passionately that it is impossible for Bosnians and Ukrainians to live in a larger country with Serbs and Russians, the Serbs inside Bosnia and the Russians inside Ukraine naturally draw the same conclusion. The logic quickly leads toward bloodshed and ethnic cleansing. This problem affects virtually all potential independent states that have not already undergone ethnic cleansing, as, for example, Poland, where Germans were expelled after World War II.

The choice, however, is not between imperial domination and sovereignty as it was defined in 1939. Americans are for the European Common Market and its recent transformation into a European Union, but still think of Germany and France as meaningful countries. Why in heaven's name should the new countries of the former Soviet Union not seek the advantages of economic integration—all the more so when they have lived for centuries in a totally integrated economy and desperately need high tariff walls to protect their technologically "infant industries" as they begin integration into the world economy?

To suggest that any movement toward integration in multi-ethnic countries such as the Soviet Union is a return to empire incompatible with Russian democracy is to foster a way of thinking that will be a disaster as we try to develop policy toward the multi-ethnic world of Asia and Africa. Instead, the essence of policy in the former Soviet Union is to decide what kind of integration will best secure freedom and autonomy for different ethnic groups and how best to promote it.

We talk about "the American prescriptions for democracy and free market," but in practice we ignore them in our advice to Russia. The American constitutional system emphasizes federalism. The American political tradition is to handle crises gradually, as with the New Deal. The United States has a mixed public-private economy, and the Clinton administration is in the midst of strengthening the government's role in the health sector that is 14 percent of the economy. We praise in the highest terms the Chinese economic transformation that retains a powerful state sector, strict price controls, and a very restrictive foreign economic program, for we realize that reform takes a long time and that 10 percent growth through 15 years of transformation is extraordinary. Only in Russia do we insist on "overnight" reform: Russia must become a privatized market economy with a free-trade foreign economic policy in two or three years, or reform is a failure.

Those associated with the Reagan administration understood that their economic and political prescriptions

abroad should legitimate their domestic policy. An administration that supports NAFTA and health care reform should understand the same point. The Reagan administration also knew how to use theater to create the impression of being in control—as it did in invading Grenada to take the deaths of marines in the Beirut barracks two days previously off the front pages. If the Clinton administration allows its critics to define the economic integration of Ukraine and Russia as a sign of Russian imperialism, it courts the same disaster at home as the Carter administration at the time of Afghanistan.

Needed: A Different Way of Talking

Finally, a vision of the reasons for Western cooperation with Russia is needed

to provide a vision of the reasons for Russians to cooperate

with the West. When more than 50,000 Russians were asked last December

whether they thought that the West has the goal of

weakening Russia with its economic advice, 54

percent answered surely or probably yes, while 28 percent

answered surely or probably not. We must find a different way of talking to Russians.

In the same poll, lead by Timothy Colton of Harvard, Susan Goodrich Lehman of Columbia, and myself, 8 percent saw the collapse of the Soviet Union as useful, 11 percent as more useful than harmful, 22 percent more harmful than useful, and 50 percent as harmful. They favored a stronger Commonwealth of Independent States by 82 percent to 5 percent and thought the Russian state should defend the rights of Russians who live in the former union republics by 92 percent to 3 percent.

Yet the Russians do not seem in an imperial mood. Only 19 percent favor a strong center, while 31 percent favor strong regions and 37 percent a sharing of power. Only 5 percent want governors to be appointed by the president, while 73 percent want them to be elected. Some 41 percent either approve or are indifferent to proclamations of sovereignty by republics inside Russia; 40 percent disapprove. By 53 percent to 33 percent, they think Russians in republics such as Komi and Yakutia should speak the local language fluently. Zhirinovsky voters are virtually indistinguishable from the average respondent on these questions, except that more want the democratic election of governors.

It is in our vital interest to explain to Russians and others in the former Soviet Union why their desires for greater integration and for a weaker center are totally compatible—and, indeed, in line with developments worldwide. We must tell them why we see them as valuable partners and allies given the enormous political and ethnic strains in the world and explain that, therefore, we do not want to weaken them. And of course, once we understand the relationship between economic reform and integration in the former Soviet Union, we may see that the Chinese model of economic reform offers lessons for Russia as well. ■



Looking Back

THE COLD WAR IN RETROSPECT

The Soviet Union and the United States waged the Cold War in the belief that confrontation was unavoidable, that it was imposed by history. Soviet leaders were convinced that communism would ultimately triumph in the world and that the Soviet Union was the vanguard socialist-communist state. They were also convinced that the Western “imperialist” powers were historically bound to pursue a hostile course against them. For their part, American and other Western leaders assumed that the Soviet Union was determined to enhance its power and to pursue expansionist policies by all expedient means to achieve a Soviet-led communist world. Each side thought that it was compelled by the very existence of the other to engage in zero-sum competition, and each saw the unfolding history of the Cold War as confirming its views.

The prevailing Western view was wrong in attributing a master plan to the Kremlin, in believing that communist ideology impelled Soviet leaders to expand their power, in exaggerating communist abilities to subvert a Free World, and in thinking that Soviet officials viewed military power as an ultimate recourse. But the West was not wrong in believing that Soviet leaders were committed to a historically driven struggle between two worlds until, in the end, theirs would triumph. To be sure, other motivations and interests, including national aims, institutional interests, and even personal psychological considerations, played a part. These influences, however, tended to enhance the ideological framework rather than weaken it. Moreover, the actions of each side were sufficiently consistent with the ideological expectations of the other side to sustain their respective worldviews for many years.

Ideology and Geopolitics

Within that ideological framework, the Americans and the Soviets carried on the Cold War as a geopolitical struggle, based more realistically on traditional balance-of-power politics than on world class struggle or global containment and deterrence theory. If ideology alone had driven the superpowers, the Cold War would be seen as arising from the October Revolution of 1917 rather than from the ashes of World War II. But in 1917 and during the next 25 years the Soviet Union was relatively weak and only one of several great powers in a multipolar

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world. By the end of World War II, however, Germany and Japan had been crushed, Britain, France, and China were weakened, and the Soviet Union, even though much weaker than the United States, seemed to pose an unprecedented threat by virtue of its massive armies and their presence deep in Central Europe. Under these circumstances, Josef Stalin's reassertion in 1946 and 1947 of the division of the world into two contending camps seemed more valid and more threatening than ever before.

Thus charged by geopolitical circumstances, a Manichean communist worldview spawned a Manichean anticommunist worldview. Each side imputed unlimited objectives, ultimately world domination, to the other. Each side looked to realize its ambitions (or its historical destiny) over the long term and thus posited an indefinite period of conflict. But even though both sides envisioned a conflict of indefinite duration, and even though policy decisions were pragmatic and based on calculation of risk, cost, and gain, the hazard of a miscalculation always existed. And that could be fatally dangerous, given the historical coincidence of the Cold War and the first half-century of the nuclear age. Nuclear weapons, by threatening the existence of world civilization, added significantly to the tension of the epoch; the stakes were utterly without precedent and beyond full comprehension.

Nuclear weapons also helped to keep the Cold War cold, to prevent a third world war in the 20th century. Nonetheless, in the final analysis and despite their awesome power, nuclear weapons did not cause, prevent, or end the Cold War, which would have been waged even had such weapons never existed. The arms race and other aspects of the superpower rivalry were, however, driven in part by ideological assumptions. As a result, while the Cold War and the nuclear arms race could be attenuated when opportunities or constraints led both sides to favor relaxing tensions, neither could be ended until the ideological underpinnings of the confrontation had fallen. And fall they did—under the leadership of Mikhail Gorbachev, who set in motion a fundamental reevaluation of the processes at work in the real world, a basic reassessment of threats, and finally a deep revision of Moscow's aims and political objectives. The United States and the West in general were cautious but eventually recognized this fundamental change and reciprocated.

Deterrence: Redundant but Reassuring

The West did not, as is widely believed, win the Cold War through geopolitical containment and military deterrence. Still less was the Cold War won by the Reagan military buildup and the Reagan Doctrine, as some have suggested.



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Instead, “victory” came when a new generation of Soviet leaders realized how badly their system at home and their policies abroad had failed. What containment did do was to preclude any temptations on the part of Moscow to advance Soviet hegemony by military means. It is doubtful that any postwar Soviet leadership would have deliberately resorted to war. That was not, however, so clear to many at the time. Deterrence may have been redundant, but at the least it was highly successful in providing reassurance to the peoples of Western Europe. For four decades it performed the historic function of holding Soviet power in check, or being prepared to do so, until the internal seeds of destruction in the Soviet Union and its empire could mature. At that point, however, Gorbachev transformed Soviet policy and brought the Cold War to an end.

Despite important differences among them, all Soviet leaders before Gorbachev had shared a belief in an ineluctable conflict between socialism and capitalism. Although Gorbachev remained a socialist, and in his own terms even a communist, he renounced the Marxist-Leninist-Stalinist idea of inevitable world conflict. His avowed acceptance of the interdependence of the world, of the priority of human values over class values, and of the indivisibility of common security marked a revolutionary ideological change. That change, which Gorbachev publicly declared as early as February 1986 (though it was then insufficiently noted), manifested itself in many ways during the next five years, in deeds as well as words, including policies reflecting a drastically reduced Soviet perception of the Western threat and actions to reduce the Western perception of a Soviet threat.

In 1986, for example, Gorbachev made clear his readiness to ban all nuclear weapons. In 1987 he signed the Intermediate-range Nuclear Forces Treaty, eliminating not only the Soviet and U.S. missiles deployed since the late 1970s but also the whole of the Soviet strategic theater missile forces that had faced Europe and Asia for three decades. What is more, the treaty instituted an intrusive and extensive verification system. In 1988 Gorbachev proposed conventional arms reductions in Europe under a plan that would abandon the Soviet Union’s numerical superiority, and he launched a substantial unilateral force reduction. In 1988–89 he withdrew all Soviet forces from Afghanistan. At about the same time, he encouraged the ouster of the old communist leadership in Eastern Europe and accepted the transition of the former Soviet-allied states into noncommunist neutral states. By 1990 he had signed the Conventional Forces in Europe Treaty accepting Soviet conventional arms levels much lower than NATO’s. By that time he had not only accepted Germany’s reunification but also the membership of a united Germany in NATO. Within another year he had jettisoned the Warsaw Pact and the socialist bloc and agreed, in the Strategic Arms Reduction Treaty, to verified deep cuts in strategic nuclear forces.

A New Concept of Security

Although Gorbachev had not expected the complete collapse of communism (and Soviet influence) in Eastern Europe that took place in 1989 and 1990, he had made clear to the 27th Congress of the Soviet Commu-

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nist Party as early as February 1986 that a new conception of security had to replace the previous one, and that the confrontation of the Cold War had to end. No longer speaking in Leninist terms of contending socialist and capitalist worlds, Gorbachev spoke instead of one world, an “interdependent and in many ways integral world.” He denied that any country could find security in military power, either for defense or deterrence. Security, he said, could be found only through political means and only on a mutual basis. The goal, he asserted, should be the “creation of a comprehensive system of international security” that embraced economic, ecological, and humanitarian, as well as political and military, elements. Hence, the Soviet decision to give new support to the United Nations, including collective peacekeeping, and to join the world economic system. Hence, the cooperative Soviet efforts to resolve regional conflicts in Central America, Southern Africa, the Horn of Africa, Cambodia, Afghanistan, and the Middle East, not to mention the Soviet Union’s support for the collective UN-endorsed action against Iraq in 1991. And hence Moscow’s willingness to countenance the dissolution of the Eastern European alliance and socialist commonwealth, which had been fashioned to meet security requirements and ideological imperatives that had now been abandoned.

In the final analysis, because the Cold War rested on Marxist-Leninist assumptions of inevitable world conflict, only a Soviet leader could have ended it. And Gorbachev set out deliberately to do just that. Although earlier Soviet leaders had understood the impermissibility of war in the nuclear age, Gorbachev was the first to recognize that reciprocal political accommodation, rather than military power for deterrence or “counterdeterrence,” was the defining core of the Soviet Union’s relationship with the rest of the world. He accepted the idea of building relations on the basis of a “balance of interests” among nations, rather than trying to maximize the power of one state or bloc on the basis of a “correlation of forces,” a balance of power. The conclusions that Gorbachev drew from this recognition, and consequent Soviet actions, finally permitted the Iron Curtain to be dismantled and the global confrontation of the Cold War to end.

Gorbachev, to be sure, seriously underestimated the task of changing the Soviet Union, and his miscalculation led to policy errors that contributed to the failure of his program for transforming Soviet society and polity. His vision of a resurrected socialism built on the foundation of successful *perestroika* and *demokratizatsiya* was never a realistic possibility. He knew deep economic reform was necessary, and he tried; he did not find the solution. A revitalized Soviet political union was perhaps beyond realization as well. The reasons for Gorbachev’s failure were primarily objective, not subjective; that is, they were real obstacles he was unable to overcome—internal opposition, powerful inertia, intractable problems of economic transformation, and the politically charged problem of redefining a democratic relationship between a traditional imperial center and the rest of the country—not unwillingness or inability to give up or modify his ideological presuppositions and predispositions.

In the external political arena, however, Gorbachev both understood and successfully charted the course that led to the end of the Cold War, even though in this area, too, at first he had an exaggerated expectation of the capacity for reform on the part of the communist governments in Eastern Europe.

American Imperialism?

The American role in ending the Cold War was necessary but, naturally, not primary. How could it be when the American worldview was derivative of the communist worldview? Containment was hollow without an expansionist power to contain. In this sense, it was the Soviet threat, partly real and partly imagined, that generated the American dedication to waging the Cold War, regardless of what revisionist American historians have to say. These historians point to Washington's atomic diplomacy and to its various overt and covert political, economic, paramilitary, and military campaigns. Supposedly designed to counter a Soviet threat, they argue, these initiatives actually entailed an expansion of American influence and dominion.

The revisionist interpretation errs in attributing imperial initiative and design to American diplomacy, but it is not entirely wrong. American policymakers were guilty of accepting far too much of the communist worldview in constructing an anticommunist antipode, and of being too ready to fight fire with fire. Indeed, once the Cold War became the dominant factor in global politics (and above all in American and Soviet perceptions), each side viewed every development around the world in terms of its relationship to that great struggle, and each was inclined to act according to a self-fulfilling prophecy. The Americans, for example, often viewed local and regional conflicts of indigenous origins as Cold War battles and acted on that assumption. Like the Soviets, they distrusted the neutral and nonaligned nations and were always more comfortable when countries were either their allies or the satellites and surrogates of the other side. Thus, many traditional diplomatic relationships not essentially attendant on the superpower rivalry were swept into the vortex of the Cold War, at least in the eyes of the protagonists—and partly in fact as a result of their actions.

True, the Cold War led in some instances to constructive American involvements. The Marshall Plan is a prime example, not to mention American support for some democratic political movements and for the Congress for Cultural Freedom and the liberal journal *Encounter*. But overt and covert involvements were more frequently less constructive, and often subversive, of real liberalism and democracy. Apart from the loss of American lives and treasure in such misplaced ventures as the Vietnam War and in the massive overinvestment in weaponry, one of the worst effects of forcing all world developments onto the procrustean bed of the Cold War was the distortion of America's understanding and values. By dividing the globe into a communist Evil Empire controlled by Moscow and a Free World led by Washington, American policymakers promoted numerous antidemocratic regimes into membership in the Free World as long as they were anticommunist (or even rhetorically so). Washington also used the exigencies of

the Cold War to justify assassination plots, to negotiate deals with war lords, drug lords, and terrorists, and to transform anticommunist insurgents, however corrupt or antidemocratic, into "freedom fighters." Alliance ties, military basing rights, and support for insurgencies were routinely given priority over such other American objectives as promoting nuclear nonproliferation, economic development, human rights, and democracy.

Parallel Soviet sins were at least as great. While Soviet foreign assistance to socialist and "progressive" countries was sometimes constructive (building the Aswan Dam, for example, or providing economic assistance to India), it was also skewed by the ideological expectation of moving the world toward communism and by expectations of Soviet geopolitical advantage in the Cold War. Often dictatorial regimes, "Marxist" or "socialist" only according to the cynical claims of their leaders, provided the basis for Soviet support, as with Siad Barre in Somalia, for example, or Mengistu in Ethiopia. The Soviet Union also engaged in many covert political operations and lent support to national liberation movements (some authentic, others less so) that sometimes included elements engaged in terrorism. On both sides, then, ideological beliefs combined with geopolitical considerations to fuel a Cold War struggle that left many victims in its wake.

Reality Check

Although the decisive factor in the end of the Cold War was a change in these beliefs, it is worth repeating that the Soviet leaders could discard a long-encrusted and familiar ideology only because of a powerful transformation in the way Gorbachev and some colleagues perceived reality, and because they were ready to adapt domestic and foreign policies to the new perception. Over time, the extent and depth of these changes became inescapable and their validity compelling, bringing the Cold War to an end. The critical culminating event was the Revolution of '89.

The year between the destruction of the Berlin Wall in November 1989 and the European conference in Paris in November 1990 saw the removal of the most important manifestation of the Cold War: the division of Germany and Europe. The division of Europe had symbolized the global battle between the two ideological and geopolitical camps in the years immediately after World War II. When that division came to an end, the consequences for the international balance of power were so substantial that even the most hardened cold warriors in the West were forced to acknowledge that the Cold War had ended—even before the collapse of communist rule in the Soviet Union or of the Soviet Union itself. Moreover, the Revolution of '89 in Eastern Europe was decisive not only in demonstrating that the ideological underpinnings of the Cold War had been removed but also in shifting the actual balance of power. The removal of Soviet military power from Eastern Europe dissolved the threat to Western Europe and also restored a reunified Europe to the center of the world political stage. Russia and even the United States have now become less central. American-Russian relations nonetheless remain of great importance in the post-Cold War world. ■

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JUDITH M.
GUERON

The federal cash welfare program—Aid to Families with Dependent Children—was created in 1935 to help children. The object was to reduce poverty without forcing mothers, primarily widows, into the labor force. Since then, numerous changes in the social landscape—women pouring into the labor market, the increasing cost of welfare, the growing number of single-parent families headed by unwed mothers, and concern about long-term reliance on welfare—have undermined the 1930s view that welfare should provide an alternative to work. The focus of AFDC has shifted from reducing poverty to reducing dependency, with welfare recast as a temporary way station on the route to work.

Since 1967 the primary thrust of reform has been making welfare less of an entitlement (if you were poor, you got money) and more of a reciprocal obligation. The theory seems simple. Welfare recipients have to look for and accept a job or participate in work-related activities such as education, work experience, or vocational skills training. If not, they risk losing benefits. In turn, the government has to provide employment-related services and supports. These “welfare-to-work” mandates are intended to speed the transition to work and to signal that welfare is not a “free ride.”

They offer people opportunities, but also seek to impose an obligation, using carrots and sticks to change behavior and make welfare less attractive. And they reach many people who might not come forward on their own.

But while the principle is simple, reality has proved complex and elusive. A mandate is real only if it offers enough activities to allow all those who are required to participate to do so—and if there are clear consequences (such as benefit cuts) for people who do not.

Since this approach first become law

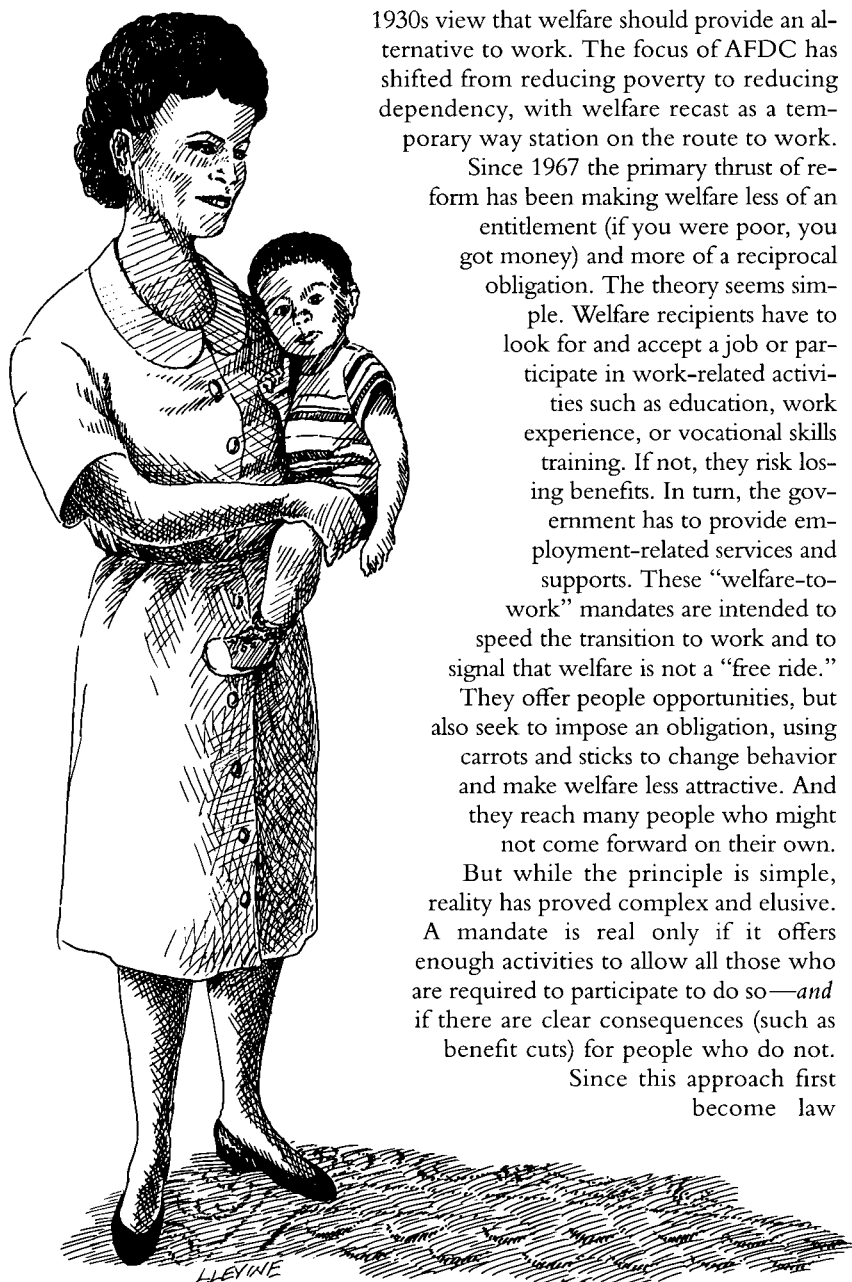
in 1971, grossly inadequate funding has meant that most people have not in fact faced a requirement. Thus the system has been spared a real test of its willingness to sanction nonparticipants.

Finding the Right Balance

Over the years the balance between opportunity and obligation has changed. In the 1970s, after an initial focus on education and training, the emphasis shifted to minimal services directed at quick job placement. During the 1980s, funding was reduced further and the typical state program continued to rely on job search assistance, sometimes also using a newly authorized option to require people to work in exchange for benefits. The Family Support Act of 1988, through its Job Opportunities and Basic Skills Training program (JOBS), sought to strengthen both obligation and opportunity—providing more resources, requiring more people, including teen mothers and others with small children, to participate, and emphasizing education and training.

Several unusually rigorous studies of JOBS and pre-JOBS programs show that a variety of approaches were successful in increasing work and reducing welfare costs. Although the results were not dramatic (and many families remained on welfare and in poverty), the programs often saved more than enough to pay back the initial government outlay, an exceptional accomplishment for a government service program. Limited resources usually hampered program operations. But when funding was adequate and management truly committed, welfare-to-work mandates changed the expectations of and opportunities for welfare recipients. Further, results from one of the few states implementing JOBS’ school attendance mandate for teen parents have shown that—with a combination of financial incentives, case management, and support services—some young mothers can be encouraged to stay in, or return to, school. Finally, states and localities adopted quite different strategies, and local ownership of program design and goals appeared critical to success.

JOBS’ largest measured impacts to date—double-digit increases in the share of AFDC recipients working, a 50 percent increase in average earnings, a one-sixth reduction in welfare payments, impressive effects on long-term recipients—were found in Riverside, California. With adequate funding to reach all mandated participants, the Riverside program communicates high expectations. People understand that they are there for one purpose: to get a job. At orientation, job developers announce job openings; throughout, staff convey a positive message about the value of work and people’s potential to succeed. Those in an education program—about half the Riverside participants are—know that if they do not complete it, or at least regularly make progress in it, staff who are



WELFARE REFORM

closely monitoring their progress will insist that they look for a job.

In Riverside, welfare has changed for everyone in JOBS. But the gap between the exceptional and the average state and local program is wide. The more typical program, while achieving positive results, remains severely strapped for funds, does not reach most of the people who could theoretically be subject to its mandates, and has not dramatically changed the message of welfare.

Challenges in Implementing Time Limits

President Clinton's welfare reform proposal would be another big step in the 25-year effort to convert welfare from an entitlement into a reciprocal obligation. The plan would set a time limit on the opportunity side of JOBS' reciprocal obligation. People could participate in work-promoting services for up to two years. After that, those who could work would have to get an unsubsidized job or, to get continued public support, work in a community service program. In some ways this proposal builds directly on the Family Support Act's vision of parental responsibility and resolves an ambiguity as to when services are to terminate. Surely, at some point, the argument went, the investment in education and training would have to end and people would have to go to work.

The public likes the idea of requiring work after two years of welfare—though, because information about costs is not available, it has not had to consider seriously what it will take to put the idea into action. As Presidents Carter and Reagan found out when they attempted work requirements in somewhat different forms, making this vision work raises tough questions. Can enough "real," rather than make-work, jobs be created? At reasonable cost and without disrupting low-wage labor markets? What will prevent large numbers of women and children from becoming destitute and homeless? How many welfare recipients cannot work? Can and will welfare administrators manage and enforce the new obligations?

The lessons from the 1980s—that well-run programs can modestly reduce, but not eliminate, long-term welfare dependency; that creating many meaningful community service jobs is hard; that monthly participation, at best, will be about 50 percent, with many acceptable reasons for nonparticipation; that adequate resources are key to effective implementation; and that state and local ownership is critical to success—point to five main challenges in implementing time limits.

Beating the Two-Year Time Limit

Time-limiting welfare, with work at the end, will be feasible and affordable only if many more people than is now the case leave AFDC *before* reaching the two-year "cliff," thereby reducing the pressure to create

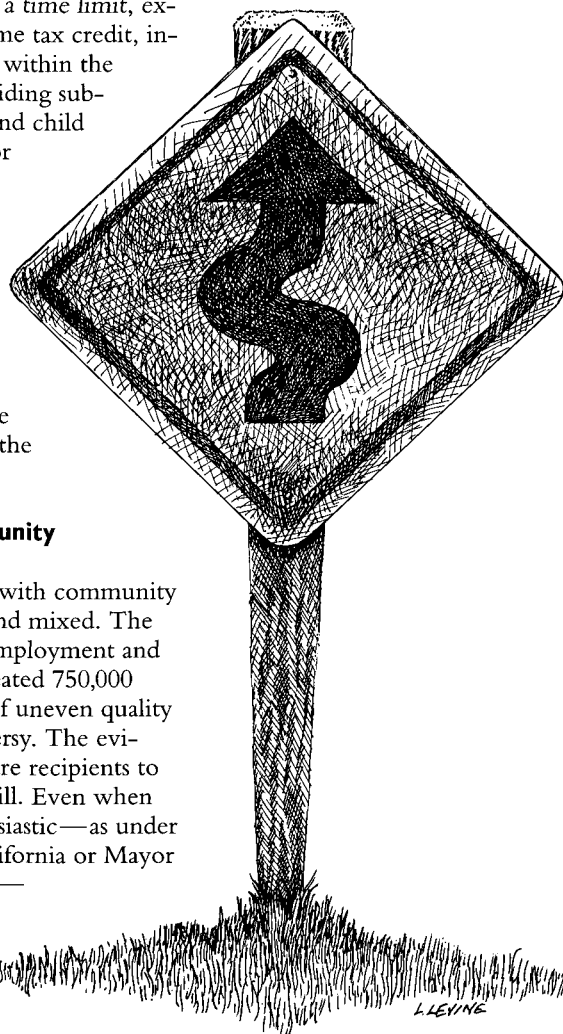
community service positions. With growing evidence that JOBS' insistence on job search, education, or training can speed the transition to work, it is becoming clear that fully implementing JOBS is not an alternative to, but a prerequisite for, any serious discussion of time-limited welfare. The goal of hard-pressed welfare administrators must be to get people off the rolls before they reach the time limit, not to keep them busy in community service jobs afterwards. Making the JOBS services and mandates real for most welfare recipients will require more money to fund and monitor the work-directed activities, federal guidance on successful strategies, and strengthened state and local commitment to operating high-performing programs.

Even if JOBS programs nationwide could match Riverside's success, however, under current rules nearly half of targeted welfare recipients would eventually reach the two-year limit. Some have argued that stepped-up efforts to involve the private sector could greatly reduce this number, but experience suggests clear limits to that approach. Others anticipate that setting a time limit, expanding the earned income tax credit, increasing work incentives within the welfare system, and providing subsidized health coverage and child care for the working poor would encourage many more people to take and keep unsubsidized jobs. These changes should increase the effectiveness of JOBS, but prudence suggests assuming that many welfare recipients will still reach the two-year cliff.

Creating Enough Community Service Jobs

The nation's experience with community service work is limited and mixed. The 1970s Comprehensive Employment and Training Act (CETA) created 750,000 public service jobs, but of uneven quality and amid much controversy. The evidence on requiring welfare recipients to work is more sobering still. Even when political support is enthusiastic—as under Governor Reagan in California or Mayor Koch in New York City—welfare administrators failed to create many community

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work experience jobs. (During an average month, New York City had 3,500–4,000 people working, out of an AFDC caseload of about 250,000.) Typical 1980s programs filled fewer than 400 positions, involving only a small percentage of the welfare population and for only short periods. On the positive side, the work was real (if not skill-enhancing) and participants thought the requirement fair. On the negative side—and in contrast to what the public anticipated—mandatory work programs cost money up-front, for developing worksites, child care, work expenses, monitoring, and enforcement, with little evidence of offsetting savings. That does not mean the work was not useful; in fact, welfare recipients produced services valued at more than the program's cost. But it does mean that mandating work costs much more than simply providing cash benefits. Responding to the need to limit the number of slots and contain child care and other costs, past welfare administrators often required only part-time or short-term work and scheduled assignments around school hours and vacations. They also learned to recycle people into job search and other work-directed services to encourage welfare exits.

Questions about the feasibility and cost of any large-scale effort to implement the work-after-two-years approach are not the only issues. Putting this vision into operation will require addressing other complex questions: Are people paid wages or do they work for benefits? What is the penalty if they do not show up for work? Will there be a time limit on work positions, and, if so, what happens after the limit is reached? How will the time clock be designed and monitored? On each of these issues, there is no obvious right answer, and different state and local administrators will have clear preferences for particular approaches.

How Many People Can't Work?

Even the toughest welfare administrators recognize that some welfare recipients face temporary or long-term obstacles to work—substance abuse, learning disabilities, emotional and physical problems, personal crises. For these people, who may not meet strict disability criteria, some fallback system will be needed to protect their children. But distinguishing this group from the able-bodied is hard: some people really cannot work, others could with adequate support. In the past, case-by-case review has been the safety valve, with caseworkers balancing society's twin goals of promoting parents' financial responsibility and protecting children. Should benefits be cut if a mother stays home with a sick child, or if she claims her car broke down or child care fell through, or if a bad back makes her temporarily unemployable? Caseworker discretion has clearly provided loopholes for some but prevented homelessness and hardship for others.

If, under time-limited welfare, participation demands are tougher, the clamor for exceptions will grow. Having no experience with fully funded work requirements, we know neither how to do this right nor what happens when it is done wrong. States will have to learn the hard way—by doing it—how to balance tougher mandates against protecting needy children. Again, this calls for flexibility and experimentation.

Getting the Bureaucracy to Implement Change

Attitudes toward welfare reform reflect varied views about social justice, equity, the causes of poverty, the role of women, the need to protect children, the goals of reform, and the responsibility of government. These themes play out differently across our diverse nation, with the often-noted result that we do not have one, but fifty, welfare programs. In the 1970s Washington directed welfare-to-work mandates, with little gubernatorial control and anemic implementation. In 1981 Congress gave the states flexibility to redesign these programs, and many governors made welfare reform a state priority, mobilizing resources and shaping programs to meet local objectives. Some states imposed tough work mandates (primarily on men), some provided opportunities for women to get out of poverty, some expanded child care services, some argued that any job was a good job, and others maintained that improved skills were essential for families to leave welfare permanently.

State and local programs tended to deliver on their own objectives—a lesson worth remembering in this new round of reform. In an area as politically charged as welfare reform, staff will vigorously implement programs that meet locally supported goals.

Paying for Reform

The additional costs and offsetting savings from a system of universal time-limited JOBS mandates followed by a work requirement are not known. Past studies of small-scale programs may understate accomplishments and costs. Furthermore, the enthusiastic public has not had to weigh its interest in making welfare mothers work against its eagerness to pay the bill. In the short term, it is clear that obtaining funds for reform will be a major constraint on implementing this vision, and that there will be a tension between paying for JOBS (upstream) or work positions (downstream).

How Does It All Add Up?

How well program administrators can meet these challenges is not clear. Nor are the likely effects and costs of different solutions. As we enter a new round of reform debates, we are armed with more questions than answers, more ambition than resources.

Current proposals would expand welfare-to-work mandates at a time when the last ones, embodied in the Family Support Act of 1988, are far from fully funded or implemented. For 20 years Congress has favored requiring people to participate in activities leading to a job, but without ever putting up the money to learn whether universal implementation was feasible, let alone what it would accomplish. Repeatedly, the talk has been tough, but the public, looking around five years later, has seen a system largely unchanged.

The record to date suggests a strategy for achieving the reforms discussed in Congress and by the administration. First, find the funds and provide the technical assistance and know-how to make JOBS' opportunities and mandates real, work-focused, and inevitable for all adult welfare recipients (possibly except those with

very young children). This first step would build on and strengthen a program of known effectiveness, put in place a precondition for time limits, and go a long way toward transforming welfare. In the process, experiment with approaches for increasing JOBS' success, particularly in moving very disadvantaged recipients into jobs, a critical step in reducing the number of people reaching the two-year cliff. At the same time, require states to implement JOBS' neglected school attendance mandate for all teen mothers.

Second, reinforce efforts to make work pay and strengthen child support enforcement, experimenting with different techniques to increase the earnings and payments of noncustodial parents. Third, in selected locations around the country, fully fund programs requiring work after a time limit has been reached. Explain to the public that the money is not there to try this everywhere, that time limits are attractive but may prove very costly or put children at risk, and that, given the unknown cost and feasibility, it is prudent to phase in the program before risking the funds and unintended consequences of full-scale national implementation. Invite the nation's governors to develop new ways to operationalize time limits, specifically testing the major alternatives in a variety of environments. Fund the most promising 10–15 states at a level sufficient, in at least part of the state, to assure a fair test of this approach: to deliver the child care, develop the work slots, and monitor participation. Provide flexibility for the other states to institute work requirements within JOBS, but under much tighter budget constraints.

If these steps are followed, in five years we will know the answers to the key questions about requiring work after two years on welfare. Is it feasible? Can the jobs be created? How many people can and cannot work? What will it cost? What are the benefits and unintended consequences? What approaches work best? We should also have identified effective strategies to succeed with long-term recipients. And the preconditions—a strong JOBS program and measures to make work pay—will be in place nationwide for expanded implementation, if warranted.

A staged phase-in may disappoint some, but the alternative is welfare reform as usual: an underfunded nationwide program, limited real change, unanswered questions about the potential for success, and a further disillusioned public. ■



KENT
WEAVER

One of President Clinton's boldest and most popular electoral pledges was to "end welfare as we know it." He promised to place time limits on receipt of benefits in the Aid to Families with Dependent Children program and to require recipients to undergo training and move into public- and private-sector jobs within two years. His objectives are clear: to give a new set of incentives to welfare recipients, lessen long-term dependence on welfare, move poor families into America's economic mainstream, and reduce poverty among American children.

The president's call for welfare reform should not come as a surprise. Rising AFDC costs and caseloads and increasing percentages of out-of-wedlock births have widened the perception that current policies have failed and have increased public and policymaker interest in reform.

Welfare reform is an unusually knotty policymaking

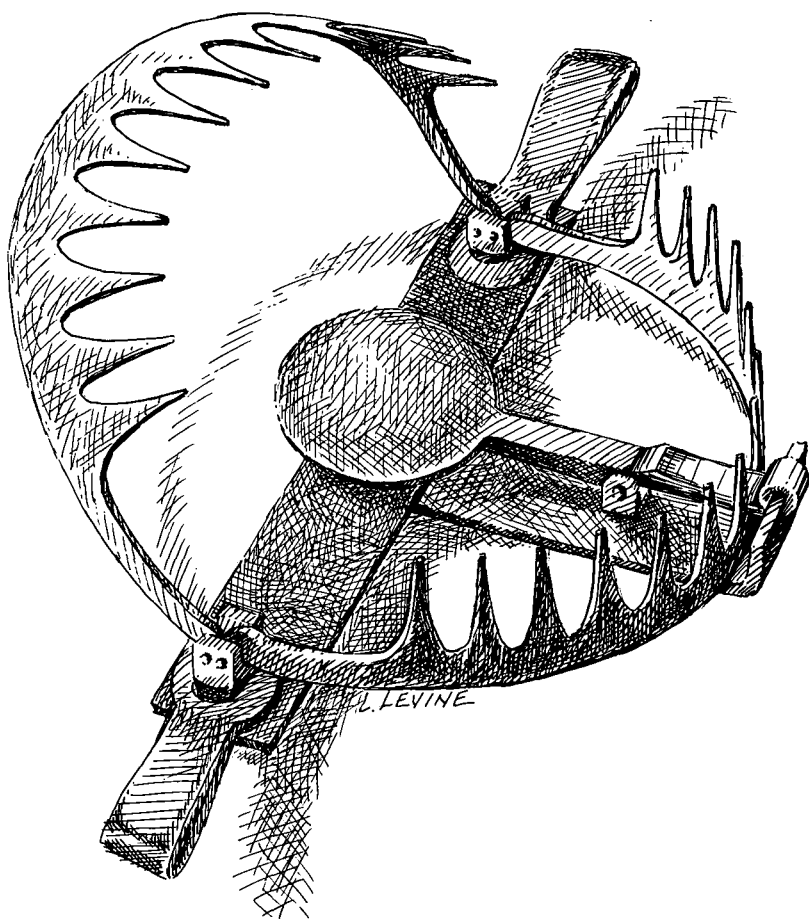
task, however. Critics of AFDC have long lamented the "welfare traps" that bedevil efforts to help poor families. David Ellwood, co-chair of the administration's task force on welfare reform, has pointed out three "helping conundrums"—problems with no satisfactory solutions. First, providing support to poor families is likely to reduce the rewards to work, as well as work effort—in some cases, increased work actually makes them worse off. Second, focusing support on families most likely to need help, single-parent families, can encourage out-of-wedlock births and divorce or separation. Finally, targeting aid to those who need it most tends to isolate recipients politically, while diminishing the relative status of those who are doing a bit better—notably working, two-parent families.

That these traps in policy design are a serious obstacle to welfare reform is widely acknowledged. Less often recognized is that reform poses a set of *political* traps, outlined below, that are equally serious and hard to avoid. All these traps have contributed mightily to the repeated failure or watering down of past efforts to reform AFDC. And all loom large in the current round of reform, often with new and more perilous twists. Thus while the public may be ready for a big change, it is far from certain that policymakers will be able to deliver it. And if welfare reform does get through Congress, it is far from clear that it will take a form that will aid poor children.

The Clinton Proposal and Its Rivals

Although details of the administration's plan remain to be worked out, its outlines are clear. Efforts to establish paternity and enforce child support payments will be stepped up. Teenage mothers will be required, in most circumstances, to live with their parents rather than set up new households. AFDC recipients will sign contracts that specify reciprocal obligations: the state will provide education and job training; the recipient will participate in these programs and take a job when it becomes available. After two years, recipients who have not found private-sector jobs will take community service jobs. These new obligations will be phased in gradually, beginning with younger AFDC mothers, in a bow to the budgetary reality that it is cheaper to pay benefits than provide jobs and support services, notably child care and transportation. Finally, state welfare offices will be reoriented—away from checking on eligibility and toward helping recipients gain job skills and find work.

The administration does not have the field to itself. The House Republican Welfare Reform Task Force has proposed a more expensive package with a greater emphasis on work requirements. They would pay for it primarily by cutting off most means-tested benefits to legal residents of the United States who are not citizens. Another Republican proposal, backed by the





conservative group Empower America, would cut off all AFDC, food stamp, and housing benefits to unmarried mothers under age 21 and encourage states to establish “orphanages” for children and group homes for unwed mothers. Both Republican plans would cap most spending programs for low-income Americans.

The shape—indeed the existence—of any final legislation depends on how these proposals thread their way through the political traps in store for welfare reformers.

The Dual-Clientele Trap

Perhaps the central political problem for American family support policy is the dual-clientele trap: policymakers can’t help poor children (which is popular) without also aiding their parents (which is unpopular); they can’t dramatically increase disincentives for out-of-wedlock childbearing without also risking making poor children worse off. Recent welfare reform debates have featured a continuing clash between concerns about ensuring the welfare of children and concerns about the behavior (and how to alter it) of parents and prospective parents. That the AFDC caseload, like the poverty population generally, is made up heavily of racial and ethnic minorities has made the debate even more contentious and inflammatory.

Many of those focusing on parental behavior are convinced that stiff punitive reforms in AFDC’s incentives structure are necessary to force recipients to change their behavior. Punitive incentives, however, would seriously harm those unable or unwilling to make the necessary changes. More important, they would hurt their children. This prospect has, until recently, kept discussions of the most draconian welfare reforms—for example, Charles Murray’s proposal to end AFDC—on the fringes of the welfare debate. But as illegitimacy rates continue to rise and other solutions elude reformers, proponents of punitive policies have begun to dominate the public debate and to deride those who voice concern for children as “paleo-liberals.” The administration has not bought into this rhetoric, but its talk of “ending welfare as we know it” has allowed concern over children to be nearly forgotten in the focus on parents’ behavior. By soft-pedaling children’s welfare, it has facilitated the weakening of the political dual-clientele trap without changing the social reality that precipitous, poorly thought out welfare reforms could lead to a social disaster for many poor children.

The Perverse Incentives Trap

The perverse incentives trap flows from the helping conundrums noted earlier. Giving cash to unmarried mothers lowers their incentives to marry or forgo childbearing. Providing them with Medicaid health insurance or child care makes it harder for them to leave AFDC and accept low-paying private-sector jobs

that offer no such benefits: if they do, they may suffer real income declines.

Perverse incentives also feed on themselves: efforts to eliminate or reduce one set can lead to a new set. For example, providing temporary access to Medicaid or child care benefits to families who leave welfare helps them make the transition—but it also encourages people who lose their jobs to go on welfare to take advantage of these benefits before returning to work. The fact is that no plausible reform of the existing system can avoid creating some new perverse incentives or worsening some existing ones.

The political trap posed by perverse incentives is this: if policymakers ignore those incentives in their reform proposals, public confidence is likely to falter when critics of reform point them out—as they surely will. But actually coming to grips with perverse incentives may be very expensive and may make reform harder to pass, as scarce resources are diverted from core reform initiatives.

The Clinton plan encounters the perverse incentives trap in several ways. First, it relies on health care reform to extend health insurance to the working poor, thus easing the way for AFDC recipients to leave welfare for low-paying jobs. But this seems to argue for delaying action on AFDC, because the projected costs and caseload estimates for welfare reform are likely to be higher (and thus harder to sell politically and harder to get through the budget scorekeeping process) now than they would be after a comprehensive health care reform package is in place—if that ever happens. Second, recent drafts of the Clinton plan propose substantial spending on child care for the working poor to lessen AFDC’s attractions for this group. But spending more on the working poor will not please lawmakers who want to concentrate resources on current recipients. Nor will it suit those fearful of making more people dependent on government aid or those who simply don’t want to spend more money.

The Money Trap

The AFDC money trap is simple: any reform likely to improve the prospects for poor children means spending more money than the public thinks is necessary or Congress wants to spend. Most people already think that too many people receive AFDC and that it is too costly. They think welfare reform should save money immediately. But few reform proposals would do that. Almost inevitably, they require at least short-term spending increases for education, job training, or other services. But to increase spending, government must increase taxes, increase the deficit, or cut other programs—all anathema to legislators. So even when Congress adopts welfare reform initiatives, they are underfunded—and therefore hobbled from the start in achieving their goals. The JOBS program of the Family

WHY WELFARE IS SO HARD TO REFORM IN 1994

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Support Act of 1988, for example, was supposed to have a dramatic impact on the AFDC clientele while increasing spending only \$3 billion over five years for education, training, and employment.

The money trap is made even worse this year by the financing proposals already on the table. The proposal by the Republican Welfare Reform Task Force would pay for its work program by stopping almost all means-tested transfers and social services to noncitizens, both legal and illegal. The Clinton plan is likely to call for a more targeted restriction on Supplemental Security Income benefits for “sponsored aliens”—family members who join earlier immigrants and are eligible, after five years, to apply for the SSI program. But both proposals raise serious political problems. States fear that they will inherit the job of caring for the immigrants. And the Hispanic Caucus in the House opposes the proposals because many affected immigrants are from Latin America.

The Overselling Trap

With AFDC so unpopular, its clientele so politically weak, and the record of derailed reform so long, legislators are reluctant to undertake reform for only modest policy gains. Thus to get welfare reform on the agenda, much less pass it, advocates must promise far more than they can deliver.

But overselling has serious costs. Not only does it threaten the credibility of specific reform proposals, it also increases public cynicism about *any* reform. If reform didn’t live up to expectations last time, why will it do so this time? Thus politicians grow even more reluctant to wade into the welfare reform swamp, necessitating yet more overpromising—and so the cycle goes.

The overselling trap this time began with the president’s promise to end welfare as we know it and to limit recipients to two years of benefits before being expected to work. The image conveyed to the public was that of an income transfer program being transformed into a work program. But the reality is different. Many welfare mothers will not be expected to work, either because they are caring for infants or because they are seriously disabled or care for children who are. But the biggest hurdle is money. Providing jobs, even low-skilled jobs, takes lots of it—upwards of \$20 billion a year for administration, transportation, and child care for all AFDC families. Thus recent drafts of the Clinton plan call for a slow phase-in and many exemptions. By 1999 fewer than 170,000 parents—out of almost 5 million AFDC families—are expected to be at work in government-provided or -subsidized jobs. Such phase-ins may be fiscally and administratively prudent, but they will not end welfare as we know it. Pressure will no doubt be felt in Congress to increase work requirements while simultaneously lowering funding levels.

The Fragile-Coalitions Trap

Too weak to make its own way, AFDC is also too unpopular to be quietly tucked into a legislative package featuring more popular programs. Its precarious political situation, together with the money trap and the

perverse incentives trap, dooms reformers to face the fragile-coalitions trap: no legislative majority can be built for reform without including lawmakers who disagree with some part of the package and who would probably defect if a separate vote were held on that part. The risk of a collapsing coalition can be minimized if reform sponsors can limit amendments, but they usually cannot, especially in the Senate.

Clinton’s coalition is particularly prone to collapse. Child advocacy groups may oppose the plan if they think it will deprive many families of cash benefits without guaranteeing a job or if it fails to provide adequate child care. Conservative Democrats may not approve its slow phase-in of work requirements. The Hispanic Caucus may oppose its financing provisions. Public-sector unions worry that a large public jobs program would displace their workers. Others fear that it could turn into another CETA public service employment program, which was so unpopular that it, almost alone among social programs, was killed outright by the Reagan administration in 1981. Limiting payments to women who have children while on AFDC is likely to be opposed by right-to-life groups, who fear it would encourage abortions, and by pro-choice groups in states that do not allow Medicaid funding of abortions.

How these conflicting pressures would affect lawmakers’ votes is hard to predict, but they could certainly provide ample reason for wavering legislators to oppose welfare reform. Neither a generous nor a highly punitive version of reform is likely to command a congressional majority, and it is far from clear that there is adequate middle ground for significant reform. Pressure for more punitive, less expensive reform is likely to grow if Congress waits until after the fall congressional elections, when Republicans are likely to gain seats, at least in the House.

The Federalism Trap

States have great leeway both in the AFDC benefits they pay and in the obligations they impose. They can also apply for waivers to deviate from existing national standards. That freedom allows states to be responsive to local conditions, such as differences in the cost of living, and to experiment to find out how changes in incentives affect recipients’ behavior. Wisconsin, for example, is testing two-year limits on benefits. New Jersey denies AFDC mothers additional payments for children conceived while the mothers are on the program.

But allowing state flexibility also poses a trap: it can subject individuals to extremely unequal treatment based on where they live, and it can start a “race to the bottom,” as states scale back benefits and impose ever more onerous obligations to avoid becoming welfare magnets.

The extent to which this federalism trap leads to reforms that hurt the poor depends in part on the other traps. If state budgets are tight—as many are because of exploding Medicaid spending—state innovations are more likely to emphasize punitive measures. And Washington’s leeway in rejecting punitive state reforms will be affected by commitments it has made.

Having promised to “end welfare as we know it,” will the administration be able to reject state efforts to impose time limits without providing jobs to those that hit the limits?

Prognosis and Recommendations

What then is the prognosis for this round of welfare reform? And what *should* welfare reform include and exclude? By their very nature, the political traps in welfare policymaking cannot be avoided. Choices must be made. And there is no such thing as welfare reform that does not pose risks for the welfare of children. But by choosing carefully, the administration and Congress can both improve the prospects for maneuvering through the traps to secure significant reform legislation *and* improve the prospect that reform will genuinely improve the life chances for poor children.

While Congress must make choices on hundreds of specific issues, four broad possibilities seem most plausible as outcomes in this round of reform. The first, and most likely, is stalemate. Second is a phased work and time limits plan, similar to the Clinton plan and perhaps allowing more flexibility to the states. Third is a stronger set of work requirements and time limits, along the lines of the House Republican task force plan. Fourth is legislation heavy on sanctions and time limits and light on funding to finance work.

Among these options the last comes closest to ending welfare as we know it, but it poses the greatest risk of leaving many poor children destitute and homeless. Nor do conservative prescriptions to rely on residential facilities (orphanages for non-orphans) for children taken away from indigent mothers make this option more palatable, even if the process of becoming homeless were an efficient way to sort unfit mothers from fit ones. Running group facilities on a large scale is difficult, and financially strapped states lack the resources to make them work well. The American experience in running programs ranging from mental hospitals to reform schools to foster care suggests that such “orphanages” would more closely resemble Bleak House than Boys Town.

The first option, stalemate, is little better than the last, if for no other reason than that it is likely to end up in the same place. By reinforcing the perception that nothing is being done about welfare, stalemate may eventually lead to radical, heavily punitive reform.

That leaves options two and three. Option three has much to recommend it—but also a powerful argument against it. We don’t know much about how time limits are likely to work. Imposing them on a nationwide scale is “Thelma and Louise” policymaking: shoot without considering the consequences, then drive off a cliff. Experiments on time limits are under way, but the results are not yet in. What combinations of time limits and sanctions for noncompliance work best, for example? Which segments of the welfare population should be targeted first? How much is homelessness likely to increase? At present, decisions about these issues are likely to be the product of guesswork informed by varying combinations of theory and prejudice, rather than by solid data. To minimize the risk that this giant policy leap into the unknown will

result in social disaster, we should be cautious in both policy design and implementation.

The second possibility, cautious and phased reform, is thus the best option—but not necessarily the most likely one. What can the administration do to improve the prospects for its plan?

First, it can change its rhetoric. With its promise to end welfare as we know it, the administration has fallen into the overselling trap in a big way. At this point, the best thing it can do is emphasize the need to make solid progress on a problem that cannot be ended overnight. It can also reemphasize the importance of children’s welfare.

The administration can do much to avoid the fragile-coalitions trap. It can state, as it did with health care, a set of bottom-line conditions—in par-

THE KEY TO MAKING PROGRESS IS SUSTAINED WORK—AND NOT JUST BY WELFARE RECIPIENTS, BUT BY THOSE WHO DESIGN AND IMPLEMENT POLICY.

ticular, adequate funding for child care and training to accompany any broad-scale time limits—that, if not met, will provoke a veto. The risk is that the minimum will become the maximum that Congress will pass. But at least such a move would ensure that welfare reform does not become a political cover for abandoning poor children.

The administration should also recognize that the lack of money to undertake a nationwide time-limits-plus-jobs program presents an opportunity as well as a problem. In the absence of good data on time limits, the administration should continue to encourage experimentation by states. It should make sure the results are carefully evaluated so that the lessons learned can be applied more broadly. But it should also clearly signal the sorts of state plans that it cannot accept—in particular, statewide time limits on benefits without an adequate jobs program at the end.

The problem of welfare dependency has, in short, no magic solutions. The key to making progress, as conservatives are fond of saying, is sustained work—and not just by welfare recipients, but by those who design and implement policy. ■

Making Health Reform Work

*John J. DiIulio, Jr.,
Donald F. Kettl, and
Richard P. Nathan*

Since the end of World War II every major domestic policy innovation in the United States has involved state and local governments. From transportation to environmental clean-up, from welfare to housing, the partnerships of American federalism have been the administrative engines of the nation's domestic policy. Federal programs have succeeded only to the degree that these partnerships have been nourished and energized.

So it will be with any conceivable national health care reform. The role now played by state and local governments in the nation's health arena—from traditional public health to the financing and delivery of personal health services to regulating providers of medical care—is tremendous. Federal policymakers reforming the nation's health care system must keep firmly in mind the vital and varied administrative tasks performed by the states in deciding who gets covered and treated, for what, how, by whom, and under what condition. They must also come to grips with tremendous administrative differences among the states. And they must recognize that no state is completely ready administratively for any given reform proposal now on the table in Washington.

Build Reforms on State Realities

In any national health care reform the states will be on the front lines. It is what the states actually do to translate federal policy rhetoric into administrative action that will most directly determine how well reform works. But states vary greatly in their capabilities, commitments, and style of health care policies and programs. When it comes to health care administration, it is no exaggeration to say that America is a loose confederation of states operating under a diverse, changing, and mind-boggling array of political, legal, budgetary, technical, and other constraints.

As a small example, a report this year by the General Accounting Office found wide differences in what state insurance departments spent on regulating health insurance. Several states spent under 10 percent of their health budgets on regulation; a few spent more than 25 percent; 14 had no actuary on staff or under contract to work on health insurance; 9 did not investigate consumer complaints against insurers; and only a few reviewed first-time premium rates before they took effect. Administratively the nation's health care system is a nonsystem, and there is little possibility that this can be changed greatly, if at all, by federal policy fiat.

Every state is now wrestling with one or more of three key elements of health care reform—coverage, cost containment, and quality—with varying speed and success. The seven states that worked with the National Commission on the State and Local Public Service in Albany, New York, last November on the implementation of health care reform as seen by the states are illustrative of the scope of reform efforts.

Reform Vanguard

Two of the seven states—Minnesota and Washington—are significantly restructuring their health care systems. In 1992 Minnesota began creating Integrated Service Networks of state providers who arrange or deliver health services to a defined population for a fixed price from a purchaser. ISNs may be formed as nonprofits or cooperatives, by health care providers, government subdivisions, HMOs, insurance companies, employers, or other organizations. A regulated all-payer system will govern all service not provided through ISNs.

To be able to participate in the Minnesota state employee benefits program, health insurance plans, and workers' compensation, all providers must participate in Medicaid and "MinnesotaCare." "Min-

nesotaCare" will offer coverage to uninsured low-income families with children and uninsured individuals with incomes up to 275 percent of poverty. Enrollees will pay for premiums on a sliding scale based on income. Coverage will be universal by 1997. Expanded access will be funded by revenues from taxes on cigarettes, hospital and provider revenue, and nonprofit service plans. A special commission will develop a plan to cut health care spending growth 10 percent a year for five years.

Washington state's 1993 Health Services Act set up four regional, noncompeting Health Insurance Purchasing Cooperatives that must each serve at least 150,000 people, allow any person or group to participate (regardless of health status), and offer every plan available in the region to its members. HIPCs are member-owned nonprofits, chartered by the state insurance commissioner, and participation in them by individuals or employers is voluntary.

By 1999 all Washington state residents will be required to purchase at least a standard benefit package. Employers must contribute at least half of the lowest price plan for all full-time employees and a prorated share for part-time employees. Employers must offer at least three plans, purchased either directly from state Certified Health Plans or through a HIPC. A commission will develop a plan for reducing the growth rate of insurance premiums by 2 percent a year until the growth rate is comparable to growth in personal income. The commission will also ensure that all residents are enrolled in a CHP or HIPC by 1999. The basis for cost containment is moderation through managed competition, with a backstop of premium growth targets for the standard benefit package. Revenues from new "sin" and provider taxes will offset some of the access expansion for uninsured populations.

On the Way, More or Less

States like California, Florida, and New York now have laws on the books that promise to lead to meaningful reform. California has implemented insurance, managed care, and cost containment initiatives to reform its health system. The Health Insurance Plan of California is available to small businesses (2–25 employees, only full-time are eligible) and offers a uniform package of benefits under four basic plans—two preferred provider plans and two HMOs. Employers must pay for at least half of the lowest cost plan offered. All small business health plans must offer all products to any small employer group regardless of health status. California is also trying to increase dramatically the portion of the population, especially state Medicaid recipients, enrolled in managed care. In addition, the Major Risk Medical Insurance Program and Access for Infants and Mothers increase access for low-income and uninsured populations through subsidized health insurance.

New York passed legislation in 1993 to expand access to primary care, encourage development of regional health networks, and allow global budgeting projects. The legislation supports the training of primary care providers, particularly those working in medically underserved areas, and increases funding for the Child Health Insurance Plan, a subsidized program for low-income children.

States like Mississippi and Texas, however, have only begun to move tentatively and incrementally toward health care reform. Mississippi, for example, has developed virtually no managed care organizations and suffers from a shortage of primary care doctors. In 1993 the Governor's Commission of Health Care began developing initial strategies in the areas of access, delivery, and financing. The state health department has also begun to establish informal networks between local community health organizations and doctors, both primary care and specialist, to ensure that the state's health care resources are used for the maximum benefit of state residents.

Clearly, the enormous differences among the states will make it

The View from the States

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impossible to administer any “one-size-fits-all” national health care reform plan. For example, there is no way that states such as Texas or Mississippi could begin to meet the timetables, alliance structure requirements, certification procedures, quality control mandates, and cost containment responsibilities specified in the Health Security Act put forth by President Clinton. For these states, and others similarly situated in administrative terms, creating the mere rudiments of regulatory structures called for in the Clinton plan would take years. To fully implement the plan would take the better part of a decade or longer.

Even states such as Washington, which would appear to be tailor-made for health reform, turn out to present large problems. For example, Washington has well-developed group purchasing policies and arrangements and has gained much valuable experience in operating its version of this administrative form. But the alliances and cooperatives called for in the Clinton plan would bear different responsibilities and operate in different ways than alliances and cooperatives now do in Washington state.

The underappreciated administrative truth is that to meet the Clinton plan’s most basic policy provisions, such “undeveloped” states as Mississippi and Texas would have to build from scratch, while such “advanced” states as Washington and Minnesota would have to tear down and rebuild. In all cases, adapting to the national plan would of necessity involve a great deal of planning time, personnel energy, and financial expense—more time, energy, and expense than any of the leading national reform plans acknowledges or allows.

Reform Must Not Hinge on the Impossible

Every health care reform plan now under consideration presupposes information and institutions that may simply be beyond the reach of any conceivable administrative technologies. Here are just a few illustrations from three major plans.

The Clinton plan would establish a 15-member National Quality Management Council to take the lead in developing dozens of national performance measures to be used to evaluate every health plan in terms of accessibility, appropriateness of health services, outcomes of health care services and procedures, prevention of diseases, and much, much more. The plan goes into great detail about the consumer surveys to be conducted to yield quality indicators on a plan-by-plan, state-by-state basis. But not a single state now has anything approaching the data-based management systems that would be necessary to conduct such performance measurement and survey tasks.

The Managed Competition Act, proposed by Congressmen Jim Cooper (D-TX) and Fred Grandy (R-IA) is virtually silent about the role of the states. But it seems clear that implementing many of its key provisions—the authorization, licensing, and oversight of accountable health plans; low-income assistance for individuals and families with incomes below 200 percent of their state’s poverty line; paperwork reduction and simplification protocols—will fall in-

evitably to the states. The act does not specify what, if any, financial or other incentives the states will receive to help them shoulder these heavy administrative burdens.

And the Consumer Choice Health Security Act, proposed by Senator Don Nickles (R-OK), often mentioned as one of several incremental reform proposals, offers nothing incremental in its administrative requirements. It would summarily preempt state laws pertaining to mandated benefits and services and require states to standardize and streamline their processing of health insurance claims. But it says nothing about precisely how this is to be achieved.

Federalism: The Key “Health Alliance”

Even with the best possible federal leadership, the number of states that could gear up relatively quickly to carry out any major national health care reform plan is a small subset of all states. But a crucial aim of national health care reform policy must be to influence *all* states, including those many states with only a limited capacity to carry out the reforms embodied in leading proposals. If any reform is to work, Washington and the states will need to meet each other half way.

Washington’s key role is to define the basic benefits to which citizens will be entitled and then allow the states to match that policy to their special local conditions. Some states are ready to go. What they need is help from the national government to put their reforms in place. Other states are unlikely to move toward the goals of reform absent new national legislation and strong encouragement from Washington. These states need incentives and requirements on a phased-in schedule that recognizes the obstacles they face. The federal government must take a sophisticated approach that sets different benchmarks for different states in working toward the same national goal.

A second federal goal is to monitor differences in quality and service among the states. One of the foremost federal responsibilities in any plan is to measure what it has wrought. Making health reform work requires rooting out and solving problems as quickly as possible. The federal government can do this only if it can track the results—in quality, ease and equity of access, and price.

The state governments, for their part, must build the bridges between government and the providers. In virtually any plan, state governments will be the link between the governmental apparatus and health care providers. This linkage will shape the kind of health care Americans will get. State governments must ensure that the linkage works to produce quality.

Managing this linkage imposes big data collection burdens. The states will be the building blocks of the national information system that will gauge the results of health reform. As the keystone of health care reform, the states will have to develop radically new and more advanced monitoring and assessment systems. To start now wouldn’t be to start too soon.

Even if the federal and state governments solve these problems, a fundamental issue will remain. Ac-

countability in government always requires that program funding be linked with management responsibilities. In any conceivable U.S. health care reform, funding and management will be disconnected. No major reform proposal now on the table envisions direct administration either by government or by private organizations. All rely on public-private partnerships. Health reform therefore will not only require building new management capacity to get the job done. It will also require that we devise new ways of ensuring that the entire system is accountable to policymakers and to the citizens who ultimately will pay the bills. This is more than a conventional regulatory or information collection problem. It demands a radically fresh approach to governance that builds the big issues of management into the fundamental policy choices. Health reform will surely disappoint us all if this does not happen.

Reform Can Work

Such a disappointment is not inevitable. Much depends on how federal policymakers choose to lead. If national health care reform becomes a giant political football, if the pressure to “pass something now” grows more and more intense, and if the political impulse to defend any particular plan or achieve any available compromise swamps the difficult search for a reform package that can both pass and work administratively, then there can be little cause for hope. But if the basic consensus on policy goals opens the door to serious reflection on policy implementation—if Washington policymakers, pollsters, pundits, lawyers, lobbyists, and the public are willing to look before they leap—then we will increase the chances of success, and, in the bargain, open up a new and inspiring chapter in our post-World-War-II history of domestic policy governance.

Under any conceivable national health care reform we will be trying to do things—in scope, scale, and time—far beyond any domestic policy initiative we have ever attempted. If we do not manage reform carefully, and if we do not wire management success into the design of the policy, we will surely court disaster. We cannot afford to punish the sick or make the healthy ill through ambitious reform that falls short of its promises while creating new and unforeseen problems.

Two general observations ought to guide the remainder of the national health policy debate. First, although a national policy presumes uniform results, neither uniform nor quick results will be possible because of the enormous variation in the system. We have to be ready to accept variations as part of the movement to any national system. We will also make mistakes. We have to be ready for them—and be prepared to learn quickly from them to make sure that they are not repeated. Second, success depends much more on management issues than anyone has acknowledged to date. To do good on health reform requires that the government make good. It is the administrative success or failure of health reform that in the end will define it. ■

Every health care reform plan now

under consideration presupposes

information and institutions that may

simply be beyond the reach of any

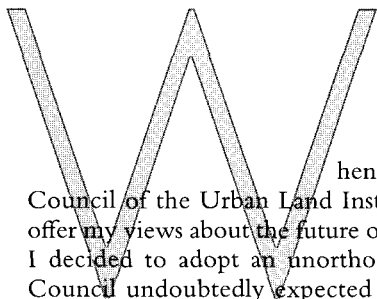
conceivable administrative technologies.

URBAN REALITIES



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SOME CONTROVERSIAL ASPECTS OF THE ATLANTA REGION'S FUTURE



When the Atlanta District Council of the Urban Land Institute invited me to offer my views about the future of the Atlanta region, I decided to adopt an unorthodox approach. The Council undoubtedly expected me, as a real estate economist, to address traditional land-use planning and real estate issues. But instead I seized this opportunity to examine what I believe are far more important challenges facing all large U.S. metropolitan areas. This approach is especially appropriate in the Atlanta region, which enjoys unusually favorable conditions compared with most other U.S. metropolitan areas. It has higher incomes, a more attractive physical environment and climate, a better transportation network, more harmonious race relations, and prospects for much faster growth. If any big U.S. metropolitan area can surmount the key problems facing all of them—crime, children being raised in poverty, low-quality public education, lack of regional governance, and huge income disparities between different groups of citizens—Atlanta should be the place. Conversely, if Atlanta can't grapple successfully with its challenges, what U.S. region can?

The Dominant Vision of Future Growth

Like most other American regions, Atlanta has gotten where it is mainly by carrying out certain growth-related policies that have dominated development throughout the nation for the past 40 years. Continuing this nationally prevailing vision—I call it the *unlimited low-density vision*—of how growth ought to occur seems likely to be the Atlanta region's strategy for the next 20 years as well. This pattern of metropolitan growth is based on pursuit of five key goals or elements. One is widespread ownership of single-family housing extending indefinitely outward from the urban center. Another is almost universal use of private automobiles for movement. Workplaces too are widely scattered and low-density, and all have adjacent free parking. Low-income households are sheltered through the "trickle down" process in which they occupy units originally built for more affluent

households. This tends to concentrate the poor in older neighborhoods near each region's center. Supporting the first four elements is a governmental structure that consists of many small and nearly autonomous local governments.

Problems Attendant on Success

Most Atlantans, like most Americans, have benefited from successfully achieving all five goals. Those who haven't—most of the region's poor—are systematically excluded from nonpoor neighborhoods and concentrated in deteriorating inner city areas. And all Atlantans face certain directly growth-related problems unexpectedly generated by their success at attaining those five goals. The problems are traffic congestion, difficulties in financing roads and sewage systems, shortages of affordable housing in growth areas, air pollution, difficulty locating airports and landfills, and shortages of recreational space.

Unlimited low-density metropolitan growth takes place through an uncoordinated, seemingly almost random set of local public policies and individual private actions carried out by separate governments and private parties. This process of "disjointed incrementalism" is cherished by many Americans, who reject the ideas of coordination and planning as almost forms of socialism. But none of the growth-related problems every region is now encountering can be solved by fragmented local governments, each acting to maximize the interests of its own citizens without regard for the rest of the region. All the problems are essentially areawide in nature, so coping with them will require much greater planning and coordination among the region's many governmental bodies. Failure to develop adequate mechanisms for regionwide decisionmaking is the first fundamental flaw in continuing the presently dominant vision of how growth should happen.

The second flaw is that Atlanta's growth strategy focuses far too much on physical and economic activities and far too little on critical social issues. In particular, Atlanta's leaders, like those in all other U.S. metropolitan areas, are unwilling to confront and at-

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DOWNS

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Note: Anthony Downs recently presented this address to an Atlanta audience. Although it discusses the future of the Atlanta region, its messages directly apply to most other large U.S. metropolitan areas as well. Therefore it has been included here as of general interest to *Brookings Review* readers.

tack the immense disparities between the incomes and educational levels of its African Americans on the one hand and its non-Hispanic whites on the other. Therefore, the rising tide of the region's overall prosperity has failed—and will continue to fail—to carry with it a substantial part of the region's African-American residents.

For example, the average 1989 income was \$41,000 for the region's white households, but only \$24,400 for its black households—40 percent lower. Although blacks make up 28 percent of the region's population, 80 percent of all children there living in poverty are black. In 1990 almost a third of the city of Atlanta's African-American population lived in neighborhoods beset with extreme poverty. The city's crime index was the highest of the nation's 75 largest cities in 1990, and the region's public schools remain highly segregated by race (see table 1). And even though African-American households have been moving out of the city and into the suburbs in the south and west, the exodus has not improved their access to new jobs, which are springing up in the northern and northeastern suburbs.

Avoiding the Problems

Atlanta's failure to face these problems squarely has been obscured by several positive aspects of its race relations. One is the longtime exercise of important powers by African Americans within the city, where they control both the municipal government and the school system. Another is the emergence of a sizable black middle class, much of which has moved to the suburbs, though not those where jobs are growing. But Atlanta's reputation for good race relations and strong black opportunities is only partly deserved. Much of the region's black community, especially within the city, has been and is being left out.

The tendency to evade dealing directly with racial inequality has been strengthened by three other circumstances, all found in most other big U.S. metropolitan areas too. First, many members of the region's white majority benefit from keeping blacks in relatively inferior positions. They do not deliberately seek such subjugation. But they do not want to change certain institutions that benefit them at blacks' expense, especially racial segregation in housing and schools.

Second, some of the institutions used to maintain white advantages—particularly zoning and other local legal arrangements that help maintain residential segregation by race—were not explicitly adopted for that purpose. So they are somewhat hidden from view. That makes it easy for most people to ignore their existence and disregard their unfair effects.

Third, even if most Atlantans wanted to change things, it would not be easy. Some key problems, such as high rates of out-of-wedlock births among black teenagers, high crime rates, and widespread drug abuse, seem intractable to public policies. In addition, residential segregation by race is hard to change because of an element of self-selection that arises because most whites and blacks define “integrated neighborhoods” differently. African Americans typically define a “desirably integrated neighborhood” as about half white and half black. But for most whites an integrated neighborhood

is no more than 25 percent black. If enough blacks move into an initially all-white neighborhood to make it more than about 25 percent black, few more whites will move in. But blacks will, because it still seems desirably mixed to them. The average residential neighborhood has a turnover of about 10–20 percent a year for reasons unconnected with racial change. When nearly all newcomers are black, it does not take long for the neighborhood to become almost totally black. Thus neighborhoods undergoing racial integration tend to become fully segregated by race even if all the whites and blacks living there, or considering doing so, prefer to live in racially integrated settings.

Creating Effective Regional Governance

Creating regional governance arrangements that can influence key land-use and transportation decisions over all the counties in the Atlanta region is absolutely essential to solving the region's pressing growth-related and social problems. Yet all such regional arrangements are vehemently opposed by most existing local government officials. They fear loss of their “local sovereignty.” In reality, however, they have no true sovereignty over key growth-related problems. Individual local governments acting independently cannot solve or even reduce traffic congestion, air pollution, or inadequate infrastructure financing.

Moreover, without a regionwide approach to social issues, most relatively affluent suburbs will simply ignore the social problems of the city of Atlanta and its poorer suburbs. Yet all suburbs are economically dependent on the city for the jobs of many of their residents, for low-wage workers, and for many vital services. And most suburbs have adopted exclusionary zoning regulations that make them partly responsible for the inner-city concentrations of poverty that generate many of the city of Atlanta's worst problems. So all suburbs have a responsibility to help solve the problems of the entire metropolitan-area community that sustains them economically.

The answer is *not* creating a single metropolitan government to replace all existing governments. Rather, it is developing a process in which existing local governments retain primary responsibility for developing comprehensive land-use plans—but must do so within a uniform framework of goals and procedures developed at the state level. There should also be a single coordinating agency at either the state or regional level responsible for ensuring that each locality's plans serve statewide goals and are consistent with the plans of surrounding local governments and major state agencies. This coordinating agency might well be the existing Atlanta Regional Commission. It has already been designated by the state as a major regional planning agency, but it has no real power to influence or shape local government plans. The power to approve and suggest changes in local plans, and require revisions in them, should be awarded to the commission. It should also have a similar power regarding plans developed by state agencies for land uses and transportation within the Atlanta region. The state might even consider making the commission an elective body with members chosen by the residents of the entire region.

Such an approach would retain the advantage of having local governments highly responsive to citizens' desires. But it would also overcome the disadvantages of having every locality make decisions totally insensitive to the welfare of the entire metropolitan area that supports it.

Race: The Number One Problem

If Atlanta—or any U.S. metropolitan area—is to grapple effectively with its crucial social problems, its citizens must explicitly recognize the importance of race in generating social and economic inequalities. They must also genuinely want to reduce major racial inequalities. Most of the planning documents Atlanta's leaders have prepared present plenty of data confirming the economically inferior position of the region's African-American population. But except for one activity—the Atlanta Project initiated by Jimmy Carter—they remain largely silent about whether that condition is good or bad—or what, if anything, should be done to change it. True, the incomes and status of many African Americans in the Atlanta region have improved in the past decade. Moreover, on average, the region's African Americans have higher incomes, education, and status than African Americans in the nation as a whole. Yet they still have much lower incomes, education, and status than the region's whites, and a much larger fraction of them are poor. Not specifically recognizing the need to improve this situation amounts to accepting present racial inequalities in the region as essentially inevitable.

Crime and Education

A survey by the Atlanta Regional Commission found Atlanta's residents aware of, and concerned about, rising crime and poor-quality public education. But they were far less aware of the close connection between these issues and the severe racial segregation in Atlanta's housing markets.

Crime, in particular, is a tough issue to cope with through public policies. The behavioral alterations needed to reduce crime and violence require major value changes among young people concerning their own and others' rights and responsibilities. But much crime and violence are also related to the region's racial disparities in income, the deteriorating family structures in the poor black community, and the inability of many unskilled black men to obtain decent-paying jobs. Policies that promote residential integration, improve living conditions for poor black households, and promote employment of black men would all have some positive impact on these problems, at least in the long run.

The Atlanta region's public schools exhibit three deficiencies also found throughout the nation. They provide few students—in either the city or the suburbs—with elementary or secondary educations comparable in quality to those in competing nations. They do not provide adequate career preparation for the majority of students who will not attend college. And they most grievously fail the children of poor black households. Students in most mainly black schools, many of which are attended primarily by children



Table 1. Race and Performance in Atlanta Region Public Schools

SCHOOL SYSTEM	PERCENT BLACK	PERCENT OF ALL BLACK STUDENTS	AVERAGE 11TH GRADE TEST SCORES
City of Atlanta	92.9	49.5	37.2
Decatur	71.9	1.0	55.0
DeKalb	43.1	32.2	50.4
Fulton	37.4	10.7	59.6
Marietta	29.2	0.9	54.4
Buford	29.1	0.3	57.4
Clayton	12.4	2.3	46.4
Cobb	4.6	2.3	65.4
Gwinnett	2.2	0.8	60.6
REGIONAL TOTAL	36.6	100.0	—

Source: Gary Orfield and Carole Ashkinaze, *The Closing Door*, p. 114, and Georgia Department of Education, *Know Atlanta* magazine, 1993. Test scores are percentile scores. In some cases, data for 1986 are not available; data for 1984 or 1982 are substituted.

**We can
no longer
accept as
inevitable
the huge
economic
and cultural
disparities
based on
ethnicity
and race
that now
exist.**

from poor households, do not receive nearly as good an education as those in mainly white schools.

It is popular today to believe that a high-quality education can be provided by schools where most students come from poor, single-parent households with little cultural experience. Indeed, pointing out that schools attended mainly by very poor children usually provide low-quality education seems racist to some people. But as long as the poorest black households are isolated in the central city and school attendance is based on neighborhood proximity, there will be no real chance to provide equal educational opportunities for their children. In the long run, to receive good-quality public schooling, more of these households must either live in more socially integrated areas or send their children to schools outside their neighborhoods. That alternative would require busing city children into suburban schools, to the likely dismay of all concerned.

Reducing Residential Segregation by Race

Residential segregation by race is central to nearly all the Atlanta region's social problems. It is critical because where a household lives affects four key aspects of life—schools, access to jobs, personal safety, and the speed at which home investments appreciate and create household wealth. All four are less favorable in most mainly black neighborhoods than in most mixed or mainly white neighborhoods, partly because black incomes are so low compared with white incomes.

As noted, residential segregation by race is partly self-perpetuating—but only at the neighborhood level. For entire sub-regions of a city to be segregated requires something more. And in Atlanta, as in the rest of the nation, a large part of the problem is continuing illegal discrimination by realtors and homeowners against black households seeking to buy or rent housing. The prevalence of such discrimination throughout the nation has been established by “testing audits” in which two couples, one black and one white, with similar economic and other traits are sent separately into the same realtor firms ostensibly seeking to rent or buy similar units. On average, in U.S. cities audited in 1977, whites were treated more favorably than blacks in 39 percent of rental transactions and 48 percent of sales transactions. A 1988 nationwide update of this study still showed discrimination in 45 percent of rentals and 34 percent of sales. Although the 1988 sample was not large enough to break out individual metropolitan areas, there is no compelling reason to believe that discrimination found in the Atlanta region in 1977 has lessened there any more than elsewhere.

While racial residential segregation between blacks and whites in Atlanta declined between 1970 and 1990, it is still widespread. The racial dissimilarity index is the percentage of all blacks in the region who would have to change census tracts in order for every individual tract to have the same racial composition as the region as a whole. For 30 U.S. metropolitan areas with the largest black populations in 1990 the index averaged 75.3 in 1970, 68.3 in 1980, and 66.5 in 1990. For the Atlanta region it was 82.1 in 1970, 78.5 in 1980, and 67.8 in 1990.

Furthermore, residential segregation by race is not

confined to low-income groups. In 1980—the latest year in which the Atlanta region's dissimilarity index for blacks and whites was computed by income levels—it was 82.2 for households with incomes under \$2,500, 77.3 for those with incomes from \$25,000 to \$27,000, and 78.2 for those with incomes of \$50,000 and over. Relatively affluent blacks were just as spatially segregated from whites as middle-income blacks and almost as segregated as poor ones.

Effectively attacking subregional racial segregation in Atlanta would probably mean adopting explicitly raced-based policies encouraging more blacks to move into the north and northeast suburbs. Many people do not regard race-based policies as appropriate today. Yet without them it is hard to see how the Atlanta region can move toward a more equitable distribution of neighborhood amenities among racial groups.

One way to reduce racial segregation is to seek out and penalize widespread racially discriminatory behavior by realtors and homeowners, especially racial “steering.” The private, nonprofit Atlanta Metropolitan Fair Housing Services (AMFHS) agency, modeled after the Leadership Council for Metropolitan Open Communities in Chicago, already performs this function. But greater funding and more powerful support from both public and private leaders within the region could make it more effective. And money from the U.S. Department of Housing and Urban Development could enable it to engage continuously in “test transactions,” sending comparable white and minority home-seekers into real estate offices and mortgage lenders to test whether they receive equal treatment. AMFHS could also establish and administer a private fund to make mortgage loans to minority households seeking to move into mainly white neighborhoods.

A second tactic would be to provide numerous inner-city black households with federal housing vouchers to be used in mainly white suburban neighborhoods. The Gautreaux project in Chicago has moved over 4,000 inner-city black low-income households to mainly white suburbs since 1976, with very positive results for the people involved. The Atlanta Public Housing Authority could assign some of its housing vouchers to that approach. Or the vouchers could be managed by AMFHS, as in Chicago.

A Little Change Could Make a Big Difference

In the 1980s in the 18-county Atlanta region, more than 350,000 new housing units were built in the suburbs. If just 2 percent of those units—7,000—had been occupied by low-income inner-city households using housing vouchers, the city of Atlanta could have moved one-third of all the households of all races in its concentrated-poverty areas, or 10 percent of all its poor households, into new suburban dwellings. Since large-scale suburban housing construction will continue in the future, it is not too late to begin now.

Why would suburban housing developers make even 2 percent of their new units available to low-income households? They probably wouldn't absent strong incentives or pressures. One way to create both would be through inclusionary zoning, which requires all developers of sizable housing subdivisions

to include a certain percentage of those units to be rented or sold at below-market prices. To make up for their resulting economic losses, developers could increase the overall density of their projects above normal levels. Some follow-on mechanism would have to ensure that the units are not shifted to non-low-income occupants in the future.

Another tactic would be to pressure local suburban governments to reduce regulatory barriers to affordable housing—for example, through a law that permits a state government agency to override local zoning decisions that unreasonably reject developer applications to build affordable housing.

These tactics would have to be enforced throughout the metropolitan region, not in just one or a few localities. One agency would thus have to implement them on a regional basis. The agency need not be the same one responsible for overall regional planning, as the Atlanta Regional Commission is now. But it should at least coordinate closely with ARC.

Adopting and successfully implementing all these tactics would not completely end racial residential segregation in the Atlanta region—or anywhere else—even within the next two or three decades. Existing residential separation between most blacks and most whites is too strongly entrenched, too supported by voluntary choices among both groups, and too sustained by average income, educational, and other differences between these groups to disappear soon. Yet simply accepting present profound racial inequalities rooted in residential segregation as inevitable, unchangeable, or even desirable would not be consistent with the basic American goal of providing equal opportunity to all.

At best, the remedies suggested above would open up many more opportunities for black households of all income groups to move into racially mixed neighborhoods. In most cases, that would permit them to enjoy better neighborhood environments, better housing, better schools, and better access to job-growth areas than they do now. This is not to imply that all-black neighborhoods are inherently inferior to racially mixed or white ones. But overwhelming evidence shows that it is difficult for the black community to create conditions in most segregated black neighborhoods that are as favorable to the residents as those in much larger numbers of white or mixed neighborhoods.

Undoubtedly, many African-American households would still choose to live in segregated neighborhoods, as of course would be their right. But many others would take advantage of expanded choices.

The Long Run

An effective attack on these social problems would require a prolonged, multi-decade, well-financed, highly coordinated set of programs and activities in both the private and public sectors. Yet no branch of the U.S. government, or of any city or state government I know of, has successfully planned or carried out *any* domestic program with all those virtues. Therefore I recognize how hard it would be to achieve such a strategy. Yet it is nevertheless worth trying to do *something* about these problems. Other-

wise the long-run costs to the region—and our whole society—of neglecting them will be immense.

A long-run strategy would require the state government of Georgia—and especially the governor—to play crucial roles. Only the state government can design and pass a regional governance structure that can cope with both growth-related and basic social problems at the metropolitan-area level. And only the state can change the underlying structure of education in the Atlanta region to make such remedies as “choice” and more autonomous schools legal.

Private-sector leadership is also crucial. Elected officials in our democracy mainly follow existing public opinion, rather than creating it. Radical new ideas must spring mainly from, and be promoted by, the private sector—business, labor, citizens’ groups, the media, and academics. If Atlanta is going to change, its own community is going to have to assume the responsibility for stimulating that change.

Also, not everything can be awarded top priority. Because resources are limited, a few goals must be emphasized. My own choices for top priority would be establishing effective regional governance over growth (since nothing much else will work without it), reforming the public education system, and starting to reduce racial segregation in housing.

Finally, a truly long-run perspective will be necessary. Even a quarter of a century will not be enough to end most of these problems. Americans hardly ever think in such long terms. But it is something we must attempt if we do not want the social problems I am describing to gravely weaken our democracy.

E Pluribus Unum?

The American experiment has tried to create one free but unified society out of people from hundreds of cultural and ethnic backgrounds. Its basic strategy has been to provide them with both individual rights and relatively equal opportunities to develop their own potentials. But we are today failing to observe many individual rights, as rising crime rates obliterate personal security in more neighborhoods. We are also failing to provide anything close to equal opportunities, as in public education and the rearing of so many children in poverty. The result is an immense gap between the income and educational levels of the white majority and of many minority groups, especially African Americans.

Yet in the next 25 years, 79 percent of the nation’s total population growth of 60 million people—47 million people—will be members of minority groups, mainly those much poorer than average. By 2020 minority group members will comprise 36 percent of our total population, and 45 percent of all young people under 18. Contemplating this future, we can no longer accept as inevitable the huge economic and cultural disparities based on ethnicity and race that now exist. Instead, we must accept the challenge of trying to reduce those disparities through direct public and private policies, rather than ignoring or evading them—as most Americans are doing today. It won’t be easy. Yet as someone once said, “If not now—when? And if not us—who?” ■

LETHAL COMPOUNDS

JESSICA EVE STERN

THE NEW CHEMICAL WEAPONS BAN

Jessica Eve Stern is a postdoctoral fellow at Lawrence Livermore National Laboratory.

This article is adapted from a longer work to be published later this year.

AFTER A QUARTER-CENTURY OF DIPLOMATIC squabbling and posturing about on-site inspections, sanctions, and side-payments, the Chemical Weapons Convention has finally been submitted to the Senate. This complicated treaty, which bans development, production, possession, transfer, and use of chemical weapons, makes unprecedented demands on parties. Thousands of chemical manufacturers will have to open their doors to international inspectors on a routine basis. Governments, even those in compliance, may be subjected to on-site, short-notice challenge inspections at facilities so sensitive their very existence has not been publicly revealed. Parties may be required to impose sanctions against violators and against nonsignatories, even if those violators are their allies. And governments will not only have to implement export controls on commercially important chemicals, but also have to enact legislation to penalize citizens who violate the controls.

Unlike the only current international law governing chemical weapons, the 1925 Geneva Protocol, the CWC bans all use of chemical weapons, not just first use. The ban makes it impossible for states to justify use of chemical weapons by accusing their enemies of having used them first, as Iraq falsely accused Iran during the Iran-Iraq War. And unlike the Nuclear Non-proliferation Treaty of 1968, there are no “haves” and “have nots.” All parties must comply with every one of the chemical treaty’s provisions.

The CWC will enter into force six months after the 65th instrument of ratification is deposited. So far, 157 nations have signed the ban, but only 5 have ratified it. U.S. ACDA’s director has testified that approximately half of the countries possessing or seeking chemical stockpiles have signed the ban. Noteworthy nonsignatories include Iraq, Libya, North Korea, and Syria.

Many analysts consider ratification by the United States a foregone conclusion because the treaty has bipartisan support in the Senate. But U.S. lawmakers and analysts have raised a number of concerns. Environmentalists consider the Army’s chosen method for destroying chemical weapons—burning—too hazardous. The Chemical Manufacturers’ Association is satisfied that the risk of loss of proprietary information in the course of inspections is minimal, but many individual companies disagree. Analysts point out that companies may argue that the treaty violates their fourth amendment rights. Some lawmakers are worried that rogue nations won’t sign the treaty, and if they do, that they will cheat. So the process of ratification will be complex and challenging.

Disputes over Verification

As has been the case with many arms control treaties in the past, verification was the single most contentious issue in the 25-year-long negotiations over the CWC. Disputes arose initially between East and West, with the East bloc arguing up until 1987 that on-site inspections would legitimize spying and the West maintaining that a chemical ban would be meaningless without a provision for “anywhere, anytime” on-site inspections with no right of refusal.

By the late 1980s most parties to the conflict had

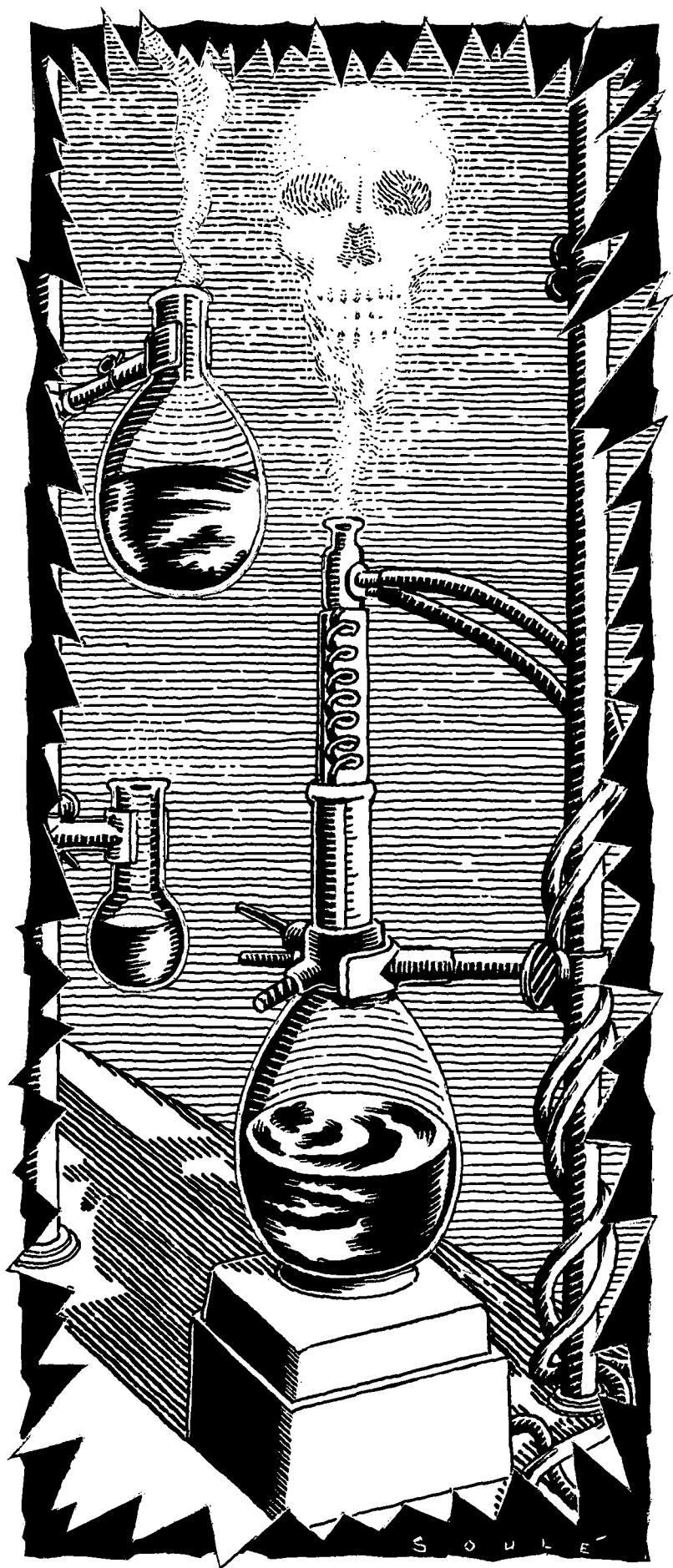
switched sides, and new contenders joined the debate. When the Soviet Union under Gorbachev accepted highly intrusive suspect site inspections, the United States concluded that risks to sensitive facilities posed by “anywhere, anytime” inspections were too great. In 1991 the United States, United Kingdom, Japan and Australia, the “gang of four,” formally proposed *less* intrusive inspections than those that the Soviet Union had supported in 1987. Meanwhile, the Cold War was ending, and the West was growing more concerned about Third World proliferation and less about Russian cheating. Third World countries long silent on the subject of verification began voicing strong objections to intrusive inspections. The United States found itself on the side of states suspected of having something to hide, including Iran, Pakistan, India, and China, and opposed by most of Europe.

Ultimately a compromise was reached. Inspectors would be granted physical access to any site, but inspected parties would be allowed to “manage access,” including to lock data or equipment in safes and to shroud sensitive equipment. These provisions eased fears that sensitive or proprietary information would be revealed during the inspections and allowed negotiators to reach agreement on a text that provides for unprecedented access to suspect or potentially suspect sites.

The final agreement provides for both routine inspections of declared facilities and challenge inspections of suspect sites. All parties must declare and submit to routine inspection all former production and stockpile sites, chemical weapon destruction facilities, activities related to chemical weapons defense, and specified types of chemical manufacturing.

Chemicals covered by the CWC are divided into three classes, depending on whether they have been stockpiled as warfare agents, how easily they could be converted to such agents, and the extent to which they are used by industry. The intrusiveness and frequency of routine inspections of chemical plants depend on the types and quantities of chemicals produced or processed. Schedule 1 chemicals are chemical agents, toxins, or immediate chemical precursors with few uses other than as warfare agents. A permitted use of the chemical agent mustard, for example, is as a chemotherapeutic agent. Schedule 2 chemicals are chemical agents or immediate precursors used in small quantities by industry. Schedule 3 chemicals are agents or precursors to agents widely used by industry. In addition, “other relevant facilities” that produce a specified quantity of discrete organic chemicals and thus pose a risk will also be monitored.

Two distinctive features of the CWC make it more effective at deterring cheating than the Nuclear Non-proliferation Treaty. First, it focuses on both facilities and materials in selecting sites for routine inspection. It targets not only sites at which specific materials are present but also those considered to pose a risk to treaty objectives. Any facility that could be converted to manufacturing chemical agents is subject to routine inspection, even if no chemical covered under the CWC has ever been processed there. And second, if any CWC party becomes suspicious about activities at *any* site—including undeclared sites where no chem-



ical manufacturing has ever taken place—it can demand a challenge inspection. The nuclear ban, by contrast, focuses principally on materials.

When the treaty enters into force, however, problems will almost certainly arise. For example, it would be easy for the treaty regime to spend most of its routine inspection funds in Western Europe, the United States, and Japan, where most schedule 2 chemical production now takes place, but where the danger of

VERIFICATION WAS THE SINGLE MOST CONTENTIOUS ISSUE IN THE 25-YEAR-LONG NEGOTIATIONS OVER THE CWC.

proliferation is small. To focus on these countries would be to repeat the mistake of the International Atomic Energy Agency, which spends more than half its inspection budget in Canada, Japan, and Germany. The decision to make “other relevant facilities” subject to routine inspection increased the number of facilities in developing countries that will be thus targeted. But if these facilities are selected solely on a random basis, the deterrent value of inspections will be slim, for there are simply too many such facilities and the cost of inspecting a fraction high enough to provide deterrence will be prohibitive. Routine inspections as now envisaged will provide a baseline picture of the world chemical industry but are unlikely to catch cheaters.

Two possible remedies exist for increasing the deterrent value of the CWC. The first is to depoliticize challenge inspections by demanding them in sufficient numbers that they are no longer associated with crises. The second is to allow parties secretly to nominate facilities for routine inspections.

Despite modifications in the challenge inspection regime, the risks posed by the CWC’s extraordinarily intrusive inspections are still hotly debated by government officials and by analysts around the world. Of particular concern to industry is who would be liable if sensitive information were revealed. Parliamentarians should bear in mind, however, that after extensive testing of the managed access approach in a series of trial inspections, the United Kingdom concluded that there was “no site so sensitive from a national security perspective that some form of access to it could not be granted, albeit rigorously managed,” and with respect to commercial secrets, “the need to protect confidentiality can be reconciled with an inspection team’s requirements for extensive access.” Recent trial inspections demonstrate the feasibility of carrying out all necessary analytical tests at the inspection site, which will further enhance protection of sensitive information at commercial as well as government facilities.

99.999 Percent Effective

Dangerous as chemical weapons are, passive defense measures against them are effective, cheap, and widely available. Modern respirators have a filtering efficiency of 99.999 percent. Although there is no proof that possession of chemical defenses deters chemical warfare, defensive gear greatly decreases the utility of chemical weapons. The defense assistance promised by the CWC to signatories that face the threat of chemical attack should be a powerful incentive for countries without defenses to adhere to the ban.

The CWC offers two forms of defense assistance. A database containing information on defense will be available to all participating parties free of charge. In addition, each party must contribute to the defense of threatened parties, either by providing defense materials directly or by contributing to a voluntary fund. Such assistance not only promotes compliance with the treaty—by increasing the cost of a stockpile large enough to inflict damage—but also makes verification easier—because the larger stockpiles required to circumvent defenses are easier to detect. And readily available defenses will make chemical warfare less effective should it occur.

More Export Controls Needed?

The CWC explicitly bans the export of chemical weapons and prohibits the export of certain precursors to nonsignatories of the treaty. Three years after the treaty enters into force, trade in schedule 2 chemicals will be permitted only among CWC parties; trade with nonparties will be banned. Until then parties may transfer these chemicals to nonparties, but an end-use certificate will be required. Export of schedule 3 chemicals to nonparties will also require end-use certificates. Five years after the treaty enters into force, parties will consider whether export controls on schedule 3 chemicals should be strengthened.

The CWC does not explicitly control exports of equipment or technologies. Nor does it provide for ongoing research into the types of chemical agents actually sought by proliferants or the types of technolo-

gies, precursors, or equipment proliferants actually use. Many CWC signatories thus favor maintaining export controls over and above those mandated by the treaty and continuing existing informal supplier cartels, such as the Australia Group. Other signatories, India foremost among them, strongly object.

Since 1984 the Australia Group, formed to stop the spread of chemical weapons in the Middle East, has been meeting to coordinate export control policies and exchange information. The group, which now includes 23 of the 24 members of the OECD plus Argentina and Hungary, voluntarily controls exports of dual-use chemical weapons equipment and 54 chemicals that could be used to manufacture chemical weapons. Other chemical-exporting states, including Belarus, China, India, Israel, Pakistan, and Russia, have also imposed controls on dual-use chemical weapons materials, with varying degrees of success.

The complicated chemical weapons export control regime is not leakproof. Australia Group members, for example, are suspected in connection with Libya's new underground facility for manufacturing chemical weapons. And China and India, who are not members of the Australia Group but have promised to abide by the same controls, are both alleged to have shipped, or tried to ship, chemical weapons precursors to countries planning to produce warfare agents.

Finally, the chemical manufacturing industry claims that the morass of export control regimes is confusing to exporters. Combining and strengthening the various nonproliferation export control regimes into a single legal entity with an expanded membership, however, is widely viewed as being impractical.

The Dilemma over Sanctions

Devising an effective sanctions mechanism has been extremely difficult. Clearly spelled out mandatory sanctions would greatly enhance deterrence. But nations are reluctant to relinquish sovereignty. Leaders are loathe to agree to impose sanctions against all violators without knowing what broader foreign policy goals may be at stake—or whether some of those violators may turn out to be friends.

The CWC is the first disarmament treaty ever to call explicitly for a collective response to violations, but its sanctions mechanism is weak. The conference “may recommend collective measures in conformity with international law,” and in particularly grave cases, bring the issue to the United Nations General Assembly and the Security Council. There is no explicit promise to impose sanctions, however. An effective sanction mechanism must be credible and punishing. Credible threats require prior commitments. But the governments that negotiated the CWC were unwilling to agree to mandatory sanctions or to spell out what the punishment would be.

One way to strengthen the CWC sanctions would be to add financial sanctions to the more conventional trade sanctions, which are usually selective and involve only specific commodities. Finding other markets for or suppliers of these commodities is far easier than finding alternative financing if the IMF or World Bank were to deem a country unworthy of

credit. Financial sanctions also tend to be the least costly sanctions to impose and the most costly to receive. Although the IMF and World Bank missions do not include enforcing nonproliferation treaties, the World Bank, at least, is now considering the environmental impact of projects it funds and is also considering taking borrowers to task for too much military spending. Including an additional criterion—compliance with nonproliferation treaties—may not be as difficult for the World Bank as for the IMF, at least for the moment. Another possibility would be to set up a Group of Seven Countries committee on counter-proliferation. A G-7 decision to impose financial sanctions against violators of nonproliferation regimes could be quite effective.

Challenges Ahead

According to Elisa Harris, Director of Nonproliferation and Exports Control at the National Security Council, although the signing of the CWC represents “the beginning of a new era in arms control,” implementing the treaty “is likely to be at least as complex and difficult a task as treaty negotiation.” The Preparatory Commission must create a new international organization and devise detailed inspection plans. Chemical companies will have to describe the quantities and types of organic chemicals they produce. Governments must establish national authorities and devise environmentally sound chemical weapons destruction plans acceptable to their people. Also, parliaments must ratify the treaty.

Those who negotiated the CWC struggled constantly with the dilemma posed by the tradeoff between ratifiability and enforceability. A stringently enforced treaty that includes export controls, intrusive inspections, and potent sanctions is, of course, most likely to deter cheating. But these same measures may deter countries from joining the regime at all because they impose heavy costs on complying parties as well as noncomplying ones.

Striking the proper balance between these competing concerns resulted in a treaty that contains, for the first time ever, an explicit threat of sanctions but keeps the sanctions mechanism purposely vague, a treaty whose inspections, unprecedentedly intrusive, nevertheless minimize risks to sensitive installations by managing inspectors' access.

Obviously there is room for improvement. But senators should be asking themselves not whether the treaty is perfect, an unattainable goal, but whether it reduces the likelihood that U.S. troops will face chemical weapons in war. They should be asking themselves whether it raises the cost to a future Saddam Hussein of gassing his own civilians. Senators should bear in mind that these weapons are inherently indiscriminate, far more effective at killing unprotected citizens than at destroying enemy targets. And they should remember that poisons have been singled out by most civilizations as uniquely abhorrent weapons. The Chemical Weapons Convention cannot prevent chemical warfare, but it can reduce its probability. Is that reduction worth the price? I believe the answer is yes. ■

INFORMATION TECHNOLOGY

THE KEY TO SERVICE PERFORMANCE

JAMES BRIAN QUINN

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During the 1980s, U.S. macroeconomic measures indicated only a 0.7 percent productivity growth in services, despite a virtual doubling of information technology investments—to \$750 billion.

If real, this apparent disparity between IT input and service sector performance—often confusingly labeled the “productivity paradox”—would have serious consequences not only for business, but for the nation. Services now account for four of every five U.S. jobs and and three quarters of the value added in gross domestic product (see table 1). If the information technology in which the service sector has invested so heavily does not improve its performance, future wealth generation, employment, wages, business profitability, and growth will all suffer.

Explanations for the productivity paradox abound. One is that the weak productivity performance of the service sector is unrelated to the investments made in IT. Rather, such things as the maturing of the sector, inefficient regulatory practices, poor worker schooling, or the sector’s inherently personalized service outputs have hindered productivity improvements.

Another possibility is that slow growth in productivity resulted from wasteful or inefficient use of IT. More optimistically, the payoffs from IT investments have merely been delayed because software, network support, or training systems have not kept pace with hardware advances. In time, measured productivity will rise and all will be well.

Which explanation to believe? According to a recent National Research Council report, IT has substantially improved service sector *performance*—but in ways that neither government data banks nor company management are yet able to measure reliably. Measuring the convenience created by a computerized reservation system is very different from counting cars that roll off an assembly line.

The Bird’s Eye View

From 1948 to 1973 several service industries—notably communications, utilities, and wholesale trade—significantly outperformed manufacturing in measured productivity growth. From 1973 to 1989 productivity gains in communications and utilities still exceeded those in manufacturing, as well as in mining, construction, and the total goods-producing sector (see table 2). But since 1973, measured productivity growth in manufacturing has exceeded that in almost all other service industries.

These figures, however, must be interpreted cautiously. Even the Bureau of Labor Statistics, which collects and calculates productivity data, notes that the measures for aggregate service sector productivity have serious limits. And trying to isolate the effects of a single input factor like IT only compounds the problem.

What are the key shortcomings in the measures? First, the outputs of many service industries are hard to define. What, for example, are the units of output for a consulting, auditing, legal, fire fighting, or museum enterprise? Second, for many key service industries, notably banking, education, health care, and government, outputs are actually measured by inputs. Third, the effects of new products and quality improvements are rarely well captured. Knowing how many procedures a hospital performs is of little use unless you know how they affected patients’ health or well-being. In addition, standard databases entirely overlook or fail to keep up with the advent of new services, such as new home health care, personal security, or entertainment concepts. Fourth, competition often robs the investing industry of the productivity benefits of its IT investments, forcing it to pass them along to customer industries. For these reasons, standard data may not indicate how much individual service industries are actually increasing productivity by means of IT. Nor do the data tell us how improvements in the sector are adding to overall GDP growth relative to manufacturing or other industries that are being served by the service sector.

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A Closer Look

Convinced that existing aggregate data cannot reliably measure either productivity growth in services or the incremental contribution of IT to productivity, the NRC took a closer look at the effects of IT in specific service industries. It focused on major users of IT, which account for about 27 percent of U.S. GDP and 35 percent of employment. For some industries, reasonably reliable output and productivity measures—for example, ton miles or passenger miles per employee in airlines—are readily available. For others, notably health care, they are not. Not surprisingly, there appear to be wide variations among industries and little correlation between IT investment levels and industry profits, growth, or productivity gains (see table 3).

All the industries scrutinized by the NRC have invested massively in mainframe computers, communications, software, data storage, networking, and distributed processing systems. Because of rapid technological advances and the need to purchase computer systems in integral units, all often experienced short-term overcapacity. Once IT infrastructures were in place, however, their costs (including maintenance) became mostly fixed. Thus it paid each competitor to cut its unit profit margins when such cuts would increase its incremental revenues. As demand saturated—or as it declined in recessions—downward pressures on average prices and percentage margins were strong, even though the services provided had higher absolute value to customers.

Performance versus Productivity

The NRC industry analyses identified many areas in which IT improved industry *performance* without increasing industry profitability or, in some cases, measured industry *productivity*.

For example, McKesson Drug, a \$7.8 billion wholesaler servicing retail drugstores, radically increased its services to customers during the 1980s. McKesson now provides extensive computer support, accounting, layout and display, and price sticker services for its drug retailers—all previously extremely time consuming and costly for manufacturers and retailers. Yet as McKesson's competitors matched its services, average wholesaling margins in the drug industry dropped from about 7 percent to 3 percent. Thus, competition forced drug wholesalers to up their IT investments without allowing them to increase margins.

Travel agents' performance too has improved. Today they can do in a few minutes what would have taken them days—or in some cases weeks—to do a decade ago. Airlines struggling to maximize revenues make an average of 175,000 fare adjustments a day and up to 600,000 on some days. Thus for a given customer's flight, travel agents must often research and re-issue tickets many times. The frequency and complexity of travel itineraries, including worldwide travel and lodging arrangements, has increased enormously; but agents' average commissions have held steady at between 7.5 percent and 9.5 percent on airline prices that have dropped in real terms since deregulation.

As public accounting firms have automated their auditing practices, they too have improved performance, handling audits more accurately at substantially lower

costs. The firms can quickly handle much more complex transactions and tax implications on a global basis, freeing CPA professionals to provide more sophisticated advice on other accounting matters. Yet competitive pressures have forced them to pass the benefits of decreased auditing hours along to their customers. As audit fees have dropped, firms have been forced into new areas, such as consulting and executive search services, to maintain revenues.

Airline operations depend heavily on IT for in-flight controls, maintenance and performance monitoring, safety systems, load management, communications, weather monitoring, and other critical activities. In addition, IT is essential for reservations, sales, marketing, pricing, logistics, and support services like meals, baggage handling, or ground crews. Airlines have invested over \$11 billion in IT hardware alone and are sophisticated users of such systems. Revenue passenger miles increased from 254 billion to 433 billion during the 1980s, and airline safety records also improved during this period.

In banking IT has enabled huge transaction growth and opened the way for a vast array of new products and services—from individually tailored loans and mortgages closed in 15 minutes to international “interest rate swaps” and “instant access” to cash or loans in any world market. No major bank could operate with the hand-kept records of the past—or successfully compete without the information on capital markets made available by IT.

In the retail industry general merchandise and supermarket chains like Wal-Mart and Safeway became increasingly dominant. Highly specialized “category killer” chains like Toys R Us or Foot Locker, wholesale clubs, super stores, and heavily focused chain boutiques also emerged as new forms of competition. All were highly dependent on IT for the continuous market analyses, broad geographic sourcing, and tight operating controls without which they could not exist. Despite the clear benefits (of improved price, choice, and convenience) to customers, average percentage margins in wholesaling and retailing generally decreased. Many companies that did not adapt disappeared, while the most successful survivors were often leaders in the use of IT.

The same pattern prevails in insurance, telecommunications, and health care. Although IT offered customers much higher quality, variety, convenience, reliability, and accuracy, service companies found it hard to capture these benefits in enhanced margins or measured output per person employed. And the culprit was not always competition.

In the \$900 billion health care industry, for example, payment practices both encouraged overcapacity and discouraged efficiency. And fear of malpractice suits undoubtedly prompted doctors to overuse some diagnostic systems and treatment procedures. Yet IT also permitted more rapid emergency responses, earlier diagnoses, less invasive procedures, better patient monitoring, improved life support systems, more precise diagnosis and treatment procedures, and even cures for formerly untreatable conditions—benefits few patients would forgo. Still, aggregate data about the medical care industry show little evidence of increased efficiency.

Across the other service industries, increased complexity, physical decentralization, and growth in transaction volumes resulting from lower handling costs often masked important performance gains as recorded by national data systems. In virtually all major service industries, rates of new product introduction burgeoned, as did geographical dispersion of operations.

Indeed, IT has changed the boundaries and definition of most service industries. New players now often venture into what were once exclusive domains. Private telephone carriers provide value-added services or handle long distance traffic for paying customers. Corporate networks sell their spare capacity to other private entities. Many companies now perform the credit, savings, exchange, and payment functions that used to be the sole preserve of banks. And airlines are now one of the larger retailing segments for goods, lodging, and tours.

In industry after industry, information technology became essential to survival or growth and resulted in demonstrably enhanced convenience and value to customers—often without showing either definable increases in industrywide financial returns or measurable productivity increases.

As Executives See IT

When the NRC asked executives how they made their IT investment decisions and how they measured the results, their answers did not focus on productivity alone, but on such things as revenue stability, risk avoidance, growth potential, strategic flexibility, or market share.

One of the most frequently cited reasons for investing was to expand or defend market share. For individual companies, of course, market share is a good indicator of performance success, as well as a basis for marketing, purchasing, and bargaining power within the industry. Increased market share may offer flexibility, predictability, and cost savings to the individual company. While IT investments that merely shift market shares within an industry will show no measurable benefit in aggregate industry statistics, they may be crucial to survival for any firm.

Executives also make IT investments to avoid catastrophic losses, such as those from airplane crashes, liability suits, or environmental disasters. These investments can provide real gains to a company and its customers, but show up nowhere—except as increased investments—in company accounts.

Sometimes IT investments can make companies more flexible, helping them survive rapid and unforeseen changes, such as more regulation or increased market or operational complexity. Such was the case with computerized reservation systems for airlines, fuel logistics systems for utilities, and intelligence systems for commodity traders. Sometimes companies invest to ensure future flexibility to allow them to create products not yet planned or even conceived—as with back office investments in banking or insurance companies. And sometimes IT may enable a company to restrain its costs while providing greater transaction volumes, variety, and location availability in its services—as automatic teller machines (ATMs) did in retail banking.

IT can also improve working conditions. Many firms, especially large retailers, wholesalers, hotels, and

Table 1. U.S. Value-Added and Employment by Industry

	1992 VALUE-ADDED (BILLIONS OF DOLLARS)		1992 EMPLOYMENT (MILLIONS)	
TOTAL ECONOMY	\$4,880.2		118.0	
Agriculture, forestry, fisheries	100.9		1.8	
Mining and construction	251.3		5.3	
Manufacturing	895.3		18.2	
TOTAL GOODS SECTOR	\$1,247.5	26%	25.3	21%
Finance, insurance, and real estate	748.9		6.8	
Retail trade	416.7		20.1	
Wholesale trade	283.6		6.1	
Transportation and public utilities	252.4		4.5	
Communications	103.7		1.3	
Other services	1,085.8		31.1	
TOTAL PRIVATE SERVICES	\$2,891.1	59%	69.9	59%
Government and government enterprises	734.5		22.8	
TOTAL SERVICES SECTOR	\$3,625.6	74%	92.7	79%

Source: Bureau of Economic Analysis, "The National Income and Product Accounts of the United States," series in the *Survey of Current Business*. Value-added data from August 1993, table 6.1C, p. 87. Employment data from August 1993, table 6.4C, p. 89. "Other services" include health care and delivery, business services, legal services, hotels, and recreation.

rental operations, invest in IT to generate information that provides greater predictability in managing operations and helps avoid undue fluctuations in sales, profitability, or employment. Other firms may invest to attract employees (in R&D establishments), improve employee flexibility and job satisfaction (as in professional firms), or enhance worker safety (as in utilities or transportation companies). IT can help eliminate burdensome tasks (in maintenance), make jobs more attractive (in accounting), shorten training cycles (in fast foods), or improve morale (in hospital critical care units). IT is an especially powerful tool for companies with life critical operations where data management can improve the safety of employees, customers, and the general public.

IT helps firms tailor their services to the needs of individual customers by serving them more rapidly, pleasantly, responsively, accurately, or completely. Such personalization strengthens customer loyalty and usually increases revenue stability and lowers marketing and post-sale service costs. By ensuring more consistent performance, minimizing errors, improving reliability, and enhancing perceptions about services—something

**Table 2. Average Annual Growth in GDP per Hour,
Major Sectors of the U.S. Economy**

	1948-73	1973-89
BUSINESS	2.88	1.08
GOODS PRODUCING	3.21	1.71
Farming	4.64	2.04
Mining	4.02	-0.82
Construction	0.58	-1.20
Manufacturing	2.87	2.75
Durable goods excluding nonelectrical machinery	2.56	2.05
Nonelectrical machinery	2.03	6.01
Nondurable goods	3.40	2.37
SERVICE PRODUCING	2.49	0.74
Transportation	2.31	0.65
Communication	5.22	4.63
Utilities	5.87	2.46
Trade	2.74	1.18
Wholesale	3.14	1.18
Retail	2.40	1.13
Finance, insurance, and real estate	1.44	0.17
Services	2.17	0.32
GOVERNMENT ENTERPRISE	-0.15	0.26
GENERAL GOVERNMENT	0.21	0.34

Sources: *Survey of Current Business*, April 1991, NIPA, tables 6.2 and 6.11; nonelectrical machinery hours from Bureau of Labor Statistics.

Table 3. Selected U.S. Service Industries, 1991

INDUSTRY	REVENUES (BILLIONS OF CURRENT DOLLARS)	EMPLOYMENT (MILLIONS OF FTE)	IT CAPITAL STOCK (BILLIONS OF CURRENT DOLLARS)	COMPOUND ANNUAL RATE OF CHANGE IN GPO PER HOUR FROM 1981 TO 1989	COMPOUND ANNUAL GROWTH RATE OF IT INVESTMENT (1981-89)
Air transport	87.5	0.7	11.1	3.1%	14.1%
Telecommunications	129.7*	0.9	114.0	5.7%	-5.1%
Wholesale trade	469.5	5.9	60.2	2.8%	11.0%
Retail trade	884.5	16.2	58.8	2.3%	9.6%
Health care	475.0*	7.4	19.6	-1.3%	9.3%
Banking	209.5*	2.1	28.5	0.1%	27.9%
Insurance (carriers + agents)	226.7*	2.2	17.1	-1.4%	30.8%

* 1990 figure

Sources: Unpublished data, BLS. IT capital stock data from Stephen Roach, Morgan Stanley. Employment data from table 6.5C, p. 84, full-time equivalent employees by industry, *Survey of Current Business*, July 1992. Labor productivity is often measured in terms of gross product originating (GPO) per hour of labor input. The GPO of an industry is a value-added measure of that industry's contribution to the gross domestic product. "Banking" consists of depository institutions only; excludes federal credit agencies, security commodity brokers, mortgage bankers. "Retail trade" includes restaurant trade.

many customers find more important than price in their purchases—IT can improve value.

Strategic IT investments allow companies to change their positioning in the marketplace, redefine themselves, or survive unforeseen competitive incursions. Strategic systems tend to change many different elements of customer, cost, and competitive relationships simultaneously—not just revenues or costs. For example, Dayton Hudson Department Stores made strategic investments in IT as its whole industry was shifting toward discount chains, malls, and high-volume specialty chains. It is impossible to sort out the losses IT investment saved Dayton Hudson in its declining markets or how much the same investments contributed to its growing Target discount chain.

Strategic IT investments often allow companies to introduce new services, which may in turn require an expanded personnel or capital base, especially in the short run. If other companies match these services quickly, duplicate investments may make industry "productivity growth" look negligible or even negative. A company's competitive edge may last only a few months. For example, executives at Citicorp said they were investing about \$100 million a year to maintain a timing advantage of about 9 months over their competitors. How much this affected aggregate yearly profitability was impossible to calculate.

Information infrastructure investments in basic computer and communications facilities pose special problems. Companies differ widely in their assessments of the benefits they derive from them. For some, infrastructures are a "cost of being in the business." It is no more possible to be in the mail order business without a telephone or the brokerage business without a computer than to be a carpenter without a hammer. In a sense, not making these investments would cost all the profits from the business. But no reasonable executive would claim that all the company's profits resulted from its IT investments.

The Quality Yardstick

Companies also invest in IT to improve quality, though few can measure in financial terms the effects of those improvements. What is the value to a customer of receiving a monthly bank statement within 48 hours as opposed to a week later, or of a neater, more professional letter, or of being able to choose from 100 financial service products rather than 50, or of a shorter wait, a more accurate sales slip, or a more relaxed clerk in a checkout line? Comparing the value of one sort of service today with that of another in the past is especially hard. What, for example, is the relative worth of today's more precise analytical and diagnostic capabilities, say in medicine or design, versus yesterday's less powerful but sometimes cheaper techniques?

Quality is also hard to measure because it often depends heavily on actions taken by the buyer. Superb educational, health care, consulting, or financial services can be useless if the buyer does not follow up properly. And sometimes a savvy buyer can convert poor quality services into astounding successes—as successful graduates from poor school systems so often prove.

Then too, the final quality of a service may not be

known until long after it is delivered—as in surgery, dentistry, or insurance. And even then, final quality may depend on whether the customer followed up, stayed well informed, or had good luck. But the customer will perceive—and receive—the service's value in terms of its actual outcome, not merely those aspects over which the producer might have had reasonable control.

Although more than 80 percent of the executives interviewed by the NRC had established formal metrics to measure the quality of their service, the metrics were almost always from engineering (system response times, computer availability percentages, and cycle times for operations) or customer survey data and could not be converted into financial measurements of output quality.

The R&D Analogy

One important panel finding was that, in the large companies surveyed, decisionmaking for IT investments resembled that for other complex advanced-technology projects both within the company and in other high-tech industries. Whenever possible, executives used standard measures for estimating financial returns and paybacks from both their R&D projects and their major IT programs. When meaningful financial measures were not available, they tended to use engineering or quality metrics to assess a project's impact. However, even then, they could rarely separate out the specific contribution of IT—as opposed to other supporting investments like training or marketing programs—in generating a given result.

This finding leads to more general observations about the way executives make decisions about IT. Just as they do with R&D, they depend heavily on intuitive and nonfinancial measures as well as formal financial justification. In some cases, results are readily measurable. In others they are not. Most companies can estimate *cost reduction* relatively precisely when IT substitutes for more labor-intensive processes or allows the shutdown of an entire facility. *New product impacts* are harder to predict, but often easy to measure afterward. Companies are especially hard pressed to predict or to measure afterward the effect of *major strategic investments*. Specific intangible types of output (like increased flexibility), certain diffuse or delayed benefits (like those from word processing, desktop communications, or spreadsheet use), or marginal quality improvements also present measurement problems. No company interviewed reported a satisfactory quantitative technique for assessing the *overall* impact of IT investments on profits, and few even tried such a justification routinely.

The analogy with other forms of R&D is striking. Most other technical breakthroughs also take years or decades to achieve paybacks, with company and industry indicators in the meantime showing low (or negative) paybacks. As with IT, few companies routinely try to evaluate the aggregate impact of all their R&D projects. Instead, they appraise effects on a project-by-project basis in terms of how well each project supports other strategic goals. For both R&D projects and IT programs, payoffs are likely to be uncertain in both scale and timing. Companies readily admit uncertainties and also that they make investment errors in both situations. Nevertheless, successful companies can and do apply rigorous—though

not always mathematically precise—analytical procedures in allocating and evaluating expenditures for IT, just as others do for R&D.

Problems in Using IT

The executives interviewed readily admitted making mistakes on IT investments. Some reported serious misjudgments about early systems, mismanagement in specific cases, and very poor implementation of IT systems, especially inadequacies in planning cross-functional or cross-divisional systems, failing to provide for retraining and continuously upgrading worker skills, underestimating the software support required by new systems, and failing to follow up IT installations with new organizational, performance measurement, and reward systems.

Such shortcomings certainly decreased the efficiency of IT installations in many companies, but, for most, the overall performance gains allowed by IT clearly outweighed these costs—and the alternative costs of other available options.

Certainly the results from IT investments could have been better in many cases. While some 80 percent of the companies interviewed felt they had received adequate to high returns from IT performance, less than 30 percent demonstrated thoroughly developed IT strategies. More than 70 percent had developed customer-based metrics for measuring quality performance, but could not yet convert them into financial measures. Many companies also admitted early errors in not reengineering processes before installing IT, but this shortsightedness was being rectified in most cases. More than 50 percent had experimented with new organizational forms when implementing their IT systems, but few had followed through completely by developing new performance measurement and reward systems in support of their investments.

Waiting for the Payoff

Despite the current inability, both in government and in industry, to measure in financial terms the productivity growth induced by IT use, by all accounts IT has enhanced *performance* in services substantially.

Although companies have been far from perfect in implementing IT, the better managed companies evaluate and allocate IT investments in ways that appear comparable to those used for other technologies and in other industries. And with U.S. service productivity comparing favorably with that in competitor nations, notably Japan, Germany, Britain, and France, there is little reason to believe that American managements have been either uniquely inept or shortsighted in IT use.

Historically, big technological breakthroughs—from steam engines to aircraft to nuclear plants—take a long time to pay off. That may also turn out to be the case for IT. Although there is no evidence that IT has been handled worse than these other technologies, IT is unique in that its outputs tend to be intangible and hard to measure. That has almost surely been one big cause of the perceived problems in IT payoff. The issue now is to learn from the past and to improve payoffs in the future, both by correcting management shortcomings and by developing better metrics for output and performance measurement at the company and aggregate levels. ■



WINNER **BUT NOT** CHAMPION

In a news conference after winning the heavyweight championship, Cassius Clay, as he was then known, responded sharply to reporters' badgering, "I don't have to be who you want me to be. I am free to be who I am." In those words Muhammad Ali declared his independence from the archetype sports hero created by those who earn their living tracking and testing the winners.

Is Bill Clinton free to be who he is? Or does he have to be what we want him to be? Certainly, Clinton was the winner in the contest that made him president. But unlike heavyweight boxing's title bout, the presidential contest cannot produce a champion—by constitutional design. The most outstanding feature of the American system of government is the separation of powers. Presidents are temporarily in charge of one institution of an interdependent government. They play a vital role, but others with authority in government will express themselves meaningfully on the limits of presidential power.

The separationist feature of the government is ignored or misunderstood by some and deplored by others. Scholars of democratic systems typically categorize the American system as presidential, even while acknowledging the separation of powers as its principal characteristic. How the White House, whose occupants move out every four to eight years, wins the label over a high-return-rate Congress, a merit-based bureaucracy, or a life-term Supreme Court is not explained.

Presidency-centered expectations of national government are also generated by many journalists and political reformers, who cling to a model of government in which a winning political party, led by its president, is expected to carry out a governing mandate. As it happens, there is much for these analysts to criticize because the demanding conditions for party government are seldom met. Not to be deterred, however, the commentators press on, testing each president and Congress by criteria drawn from a model rejected at the Constitutional Convention. Meanwhile, the most common form of government in the post-World War II period—a president of one party, a majority of the other party in at least one house of Congress—is viewed as a mistake to be corrected.

So, like other presidents, Bill Clinton is free to shape his pres-

President Clinton and the Separated System

CHARLES O. JONES

idency, understanding that others will define it as well. He is well advised in this exercise to resist the temptation to meet presidency-centered expectations. Those who favor this perspective seek the champion that no president can be. All presidents are winners, however, and their victories carry their own entitlements. A presidential win in the separated system confers the right to find one's place in the continuous government. In other words, presidents are authorized to use their political,

personal, and policy advantages to persuade others to accept their leadership.

Presidents Are Not Created Equal

Presidents enter the White House under very different circumstances. Some elected first-termers like Eisenhower (1952) and Reagan (1980) had impressive wins; others like Kennedy (1960), Nixon (1968), and Carter (1976) prevailed by the narrowest of margins. Since World War II there have been three reelected presidents, Eisenhower (1956), Nixon (1972), and Reagan (1984). All were Republican, all won in landslides, and yet all faced Democratic majorities in Congress (one house or two). Takeover presidents—Truman (1945), Johnson (1963), and Ford (1974)—assumed someone else's presidency. Two takeover presidents were themselves elected, Truman in 1948 and Johnson in 1964, in yet another variation in White House occupancy. Finally, there was one elected heir apparent, Bush (1988), whose situation resembled that of the takeover presidents.

If, as rarely happens, all goes well in the election for the president and his party in Congress, a mandate is declared that allows the president to pursue an assertive policy strategy, at least until the mid-term elections. The years since 1945 have seen only two clear-cut mandates—Johnson's in 1964 and Reagan's in 1980—and those went in opposite policy directions. More often the policy message has been hard to read. In some cases the president won narrowly, as with Truman (1948), Kennedy (1960), Nixon (1976), and Carter (1976), and congressional results were mixed. In such cases a compensatory strategy is advised to bolster the president's position organizationally or substantively in working with Congress. For the three reelected presidents returned to head a split-party government, a guardian strategy, one designed

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to protect earlier achievements, appears appropriate. And the right strategy for the nonelected, takeover presidents depends heavily on the legacy of their predecessor—custodial for Truman and Johnson, more restorative for Ford.

The Clinton Case

How does Bill Clinton fit into the separated system? With whom should he be compared? What strategy should he pursue? How should he organize and develop his presidency? What can we expect by way of legislative production during his term in office?

In electing Clinton, voters chose a single-party, Democratic government for the first time in 12 years, the second time in 24 years. But they did not alter the fundamental separationist feature of American national government, which had, in fact, been strengthened during the interim period of split-party government. Congress, in particular, had vastly improved its capacity and hardened its resolve to participate more actively in phases of the policy process—setting agendas, defining problems, developing and implementing programs—earlier thought to be the province of the executive. The mere election of a Democratic president would not cause Congress to forgo its new institutional positioning. Members of Congress would certainly expect to participate actively in fashioning policy responses to Clinton initiatives.

Seeing how Bill Clinton fits into a separated system with enhanced congressional capacity and participation begins with the 1992 election and how it is interpreted as a source of policy and political strength for the president. Clinton won the three-way race—whose dominant theme was “change”—with one of the smallest percentages of the popular vote of any president in this century. If “change” voters are defined as those not voting for George Bush, then Clinton shared them with Ross Perot, roughly on a two-to-one basis. “Change” was likewise a theme in the congressional elections, where the mood was also anti-incumbent. Huge numbers of endangered incumbents retired, others lost in primaries. The Democrats retained their majorities in Congress but by a reduced margin. Most incumbents who won saw their margin of victory shrink.

Clinton’s win put him into the category of elected first-termers who win narrowly and whose logical governing strategy is *compensatory*. Democrats in Congress, for example, all of whom exceeded Clinton’s vote in their states and districts, would scarcely be expected to fall easily into line solely based on their reading of the 1992 election returns. On the other hand, Democrats were back in charge of the government after 12 years and shared a common fate. Most congressional Democrats want this new-generation president to succeed.

An Unconventional Strategy

A compensatory strategy acknowledges explicitly that the president’s major post-election assignment is deciding how to fit himself into an ongoing government, many if not most of whose employees are there when he arrives and will still be there when he leaves. Critical to achieving that task is identifying policy and political goals and understanding strengths and weaknesses for accomplishing them.

President Clinton has impressive personal skills associated with his policy interests and knowledge and his ability to communicate with the public. He relies on these skills as the principal compensation for a mixed electoral record. In fact, he has depended heavily on this campaign-oriented tactic in garnering support for

his proposals—especially since the failure of an inside strategy for passing his economic stimulus package in 1993.

The president’s use of this tactic makes it more difficult for him to use a more conventional compensatory strategy, one that relies less on personal skills and more on organizational and institutional structures to help him realize his policy goals in the permanent government. Creating such structures, of course, requires delegation. But delegation comes at a cost of sacrificing personal discretion. If the president’s strength in style is too free-wheeling to suit organizational demands or if he has more confidence in himself than in his subordinates, delegation will be difficult. Yet not even the most brilliant mind and energetic body can expect to fulfill all that is expected of a president in a separated system. Further, others in government will demand to see the president, not trusting that his minions represent his authority extended. And so by his own rationale, the president will have to give them an audience.

Another challenging feature of the Clinton presidency is the innovative role of the first lady, Hillary Rodham Clinton. Having a roving advisor in the White House, as, for example, Harry Hopkins was for Roosevelt, has always been somewhat unsettling to others in the government. When that person is a family member, like Robert Kennedy for his brother or Nancy Reagan for her husband, apprehension is greater still. Kennedy, however, had clearly designated duties as attorney general and Mrs. Reagan seemed interested primarily in protecting her husband, exercising influence mostly on personnel matters. Mrs. Clinton has responsibility for health care reform, the president’s top policy priority, as well as strong and active interests in other issues of central importance to her husband’s presidency.

Then there is the active policy role for the vice president. Clearly the president does have confidence in Al Gore, entrusting him with responsibility for major policy issues, thus creating another power center in the White House. There is precedent for an active vice president, as Walter Mondale was for Jimmy Carter, but Gore’s status is extraordinary.

In the separated system, presidential power is defined as much “outside,” among others in government, as “inside,” among those serving temporarily in the White House. How are those outside to orient themselves to an essentially nonhierarchical and poorly articulated organization that attempts to recreate the campaign for each issue and within which either the president, the first lady, or the vice president has primary influence and control? Members of Congress and their staffs, cabinet officials, and senior executives may initially orient themselves to the president as a conventional organizational leader but then proceed on their own, essentially redefining the role of the White House to suit changing conditions and perceptions of who is in charge of what. The president must find his place in the separated system or it will be found for him.

The Clinton presidency surely challenges the separated system. In spite of a limited electoral mandate, the president has pursued an ambitious program with an unconventional organizational and fluid strategy. His approach to Congress has been campaign-style—from the outside in, seeking to translate his personal enthusiasm into public support. His organizational concept, to the extent that he has one, is also personal in nature, with the president at the center in constant motion and a staff, all with equal access, striving to keep up—a sort of “spokes of the amoeba” notion. And his partner in life, politics, and government occupies a critical, yet historically and structurally unspecified position of influence.

The Record So Far

A common mistake in evaluating the American system is to measure achievement entirely by presidential success. But, in fact, one outstanding feature of the separated system is the continuity of government and its work. Overstating the role of the president means understating the capacity of the rest of the system to act under varying political conditions. Thus, for example, it is believed by some that split-party governments result in stalemate or that Congress cannot compensate for presidential inattention to issues or that so-called "lame duck" periods are unproductive or that scandal in the White House paralyzes the government. In his recent book, *Divided We Govern*, David R. Mayhew identifies 267 major pieces of legislation in the post-World War II period and finds no difference in production between single- and split-party governments. He also finds high productivity during the presumably paralyzing Watergate scandal. My own detailed analysis of lawmaking for a sample of Mayhew's list shows an increasingly active role for Congress, to include taking initiative when the president is less active.

In the case of the Clinton administration, it is useful to step back from the breathless news coverage that a personalized and innovative presidency invites to consider its contribution to the workings of the contemporary separated system. Although it is too early for a definitive answer, it appears, especially in regard to domestic policymaking, that the Clinton style facilitates the workings of a post-split-party government. As noted, Congress has, in recent decades, developed a capacity and taste for being actively involved in many phases of the policy process. The president has shown an extraordinary talent for identifying major issues, many of which have long been on the nation's agenda, and then for building public interest in them and maintaining their priority status. Though he typically offers a plan, he also conveys the message that he is willing to bargain—quite unlike the less compromising stances of Jimmy Carter. Thus, those members of Congress who have grown accustomed to active policy roles can be satisfied that they retain influence in the new government.

Can this version of the separated system produce? The record suggests that it can. A number of legislative initiatives that were already in the pipeline have been enacted into law. Other significant proposals on major issues, most notably health care, are now making their way through Congress. In fact, the bulk of the agenda for the 103rd Congress had a lineage traceable to previous administrations and Congresses. Health care, education, welfare, trade, crime control, family leave, retraining—these are not new issues.

Much recent commentary expresses surprise that a beleaguered administration could accomplish so much in the face of the Whitewater diversion. The legislative production is attributed in part to the eagerness of Democrats in Congress to demonstrate

It appears, especially in regard to domestic policymaking, that the Clinton style facilitates the workings of a post-split-party government.

that they can produce in spite of the president's problems. That a separated government is fully capable of compensating for the weakness or distraction of one part is seldom acknowledged.

In fact, far from immobilizing the capital, Whitewater, despite the media preoccupation with its many dimensions, is of relatively little importance to the ongoing government. Because of the personal nature of the Clinton presidency, the effect is primarily on the White House staff, which tends to measure success or failure by the positive or negative press coverage of the president. While Whitewater commands a great deal of staff time and energy in the White House, the rest of the government proceeds apace. During early March, for example, the White House staff had to cope with the resignation of the president's chief counsel, Bernard

Nussbaum; the issuance of a number of subpoenas by Special Counsel Robert Fiske; further revelations regarding the Clintons' financial affairs; and demands for congressional hearings. Meanwhile members of Congress were at work on the president's budget, an education bill, lobbying disclosure, an anti-crime measure, health care reform, communications regulation, and federal worker buyouts. Thus, for example, on March 16 and 17, when an evening news viewer in Keokuk, Iowa, might have thought that the Washington work day was devoted exclusively to Whitewater, 27 Senate and 61 House committee meetings, not one of which dealt directly with Whitewater, had been in session on Capitol Hill.

A President, Not a Presidency

Bill Clinton is authorized to shape his presidency as he sees fit. He has chosen a highly personalized, campaign-oriented, and innovative form suitable to our present version of separated government in that it accommodates the greater policy role of Congress developed during periods of split-party government. The fact is that an active and relevant agenda is being exposed and the work of government in most departments and on Capitol Hill is being done. Far from gridlock, the separated government is doing its job.

The Clinton style is, however, risky for him and demanding on his staff. By drawing attention to himself he feeds the popular misconception that the president is the presidency, that the presidency is the government, and that ours is a presidential system. There is, then, no relief for him since his performance invites exactly the unrealistic expectations accompanying a presidency-centered, party-government perspective.

But of course Bill Clinton is not the sole judge of what his presidency will be. Observers are, therefore, encouraged to use a more realistic test, one that concentrates less on the president as a person and more on the presidency as an institution, defined not just by who the president thinks he is but also by how others define his role in the separated system. ■

IAEA: Mission Impossible?

BRUCE G. BLAIR



The game of cat-and-mouse being played between the government of North Korea and the inspectors from the International Atomic Energy Agency is giving new life to the old myth that IAEA safeguards are the centerpiece of nuclear nonproliferation. In reality, IAEA inspections cannot stop the bomb from spreading—to the Korean peninsula or anywhere else. The responsibility for that lies with international efforts involving savvy diplomacy, mediation, and economic and political incentives and sanctions.

The suspense surrounding the inspection stonewalling by North Korea should not obscure the agency's limits. Both its mission and safeguards effectiveness are weaker than commonly assumed. In the first place, preventing nuclear proliferation is not its mission. The IAEA does not physically protect nuclear materials from diversion or theft by nations, criminals, or terrorists. That policing function belongs to the individual states. Even if North Korea submits to IAEA safeguards, it will have total access in the future to any and all weapons-grade nuclear material it produces.

The missions of the agency are verification, deterrence, and detection. Verification, essentially a confidence-building effort among voluntary, cooperative parties, is the primary goal. The idea is to enable a country to assure its neighbors, and others with stakes in the matter, that it is not diverting nuclear materials to build a bomb. Submitting to independent inspection lends credence to its assurances. In the case of North Korea, which seems bent on projecting a regional nuclear capability or at least maintaining an aura of nuclear ambiguity, the relevance of this IAEA mission is dubious.

Deterrence is a distant second mission. After all, if nations truly seek to assure others that they are adhering to their promise

not to divert nuclear materials to weapons, the risk that the IAEA would detect a diversion seems largely irrelevant. On the other hand, states determined to acquire a nuclear bomb can simply refuse to join the Non-Proliferation Treaty and avoid the IAEA safeguards altogether—India, Pakistan, and Israel being examples—or pursue a covert program that largely escapes the eye of IAEA inspectors, as Iraq did so successfully. Ironically, only states that do not need to be deterred can be adequately safeguarded against possible diversion, because the safeguards needed to do so are the same ones needed to provide credible verification assurance. IAEA safeguards surely have not kept North Korea from diverting materials to nuclear weapons, just as they have not provided any reassurance of non-diversion.

The third mission is to detect a diversion in time for diplomatic efforts to prevent a proliferant state from building a nuclear weapon. Diverting as little as 8 kilograms of plutonium would enable a state to produce a bomb within months. Timely detection is thus a big challenge to the IAEA, which strives to achieve a detection probability of about 90 percent and a false alarm probability of 5 percent.

But these detection goals are in many instances practically, and in some instances inherently, unattainable. Detecting the diversion of one bomb's worth of plutonium from certain reprocessing facilities, for instance, is virtually impossible.

Even if North Korea granted unfettered access to all materials and sites, the IAEA could not meet the stipulated detection goals. Consider the key inspection issue at this time: IAEA access to the spent fuel rods being withdrawn from the suspect reactor at Yongbyon. The agency wants to sample the isotopes in the rods to determine whether

the plutonium removed by North Korea during a 1989 reactor shutdown amounted to only 90 grams, as the regime claims, or 8–9 kilograms, as the United States charges. Under some diversion scenarios—for instance, if the regime diverted the larger amount but replaced all the old rods with new ones in 1989—the probability of detection would be only about 70 percent. If no such diversion occurred, the odds of falsely accusing the North anyway would exceed 10 percent. With such error rates, the IAEA could not reach a final verdict any time soon, despite international pressures to do so.

The IAEA needs time to get to the bottom of a nuclear story. In early 1993 South Africa confessed to having a large covert nuclear program, invited the IAEA to investigate, and granted access to all records and persons involved. Still, the agency took a full year to verify South Africa's claims.

In short, the IAEA is shouldering far too much of the burden of nonproliferation in Korea. For Washington to insist on the imposition of IAEA safeguards as a precondition for high-level talks with North Korea is putting the IAEA cart before the nonproliferation horse and hiding behind the cart to boot. If the regime has any intentions of abandoning its nuclear ambition, it in all likelihood will reveal them only during negotiations on a package deal that confers diplomatic status on the North and offers it economic aid in exchange for dismantling its nuclear program and sealing its lethal products under IAEA safeguards.

Even then there are no iron-clad guarantees. North Korea may invent a new charade and again circumvent safeguards. The reality is that nonproliferation in North Korea hinges far less on IAEA inspections than on the regime's calculation of the benefits of embracing it. ■

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Financial Markets and the Fed

BY GEORGE L. PERRY



In mid-May the Federal Reserve's open market committee raised the federal funds rate by $\frac{1}{2}$ point to $4\frac{1}{4}$ percent, bringing the total increase to $1\frac{1}{4}$ points since it first started tightening policy in early February. Significantly, the Fed said that, with this latest increase, it had removed the monetary accommodation of 1993. Translating from the Delphic language that central bankers favor, this appears to mean it has raised the funds rate as much as it intends to in light of present economic conditions.

This latest decision was taken against an unusual background in financial markets. Most surprisingly, market interest rates of longer maturities—including long-term rates on bonds and mortgages as well as rates on debt instruments maturing in one or two years—had risen substantially more than the $\frac{3}{4}$ percentage point by which the Fed had raised the federal funds rate before its latest increase. Measured from their October lows, many market rates had risen twice as much as the funds rate. Historically, by contrast, long-term rates have typically moved much less than the federal funds rate in response to countercyclical moves in monetary policy.

This unusual behavior of market rates relative to Fed actions raises the dual issues of how the Fed should guide and be guided by the markets. On the first, it is clear that Fed policymakers need to consider how their actions are likely to affect market rates, since it is those rates that most directly impact the economy. Indeed, as the Fed was meeting to make its latest federal funds rate move, the large recent increases in market rates were already exerting a restraint on the economy equivalent

to more than the $\frac{3}{4}$ point by which the Fed had raised the funds rate.

On the second issue, Fed policymakers should be wary of looking at markets as a source of information about what policy actions to take. Markets process information about the economy, including the likely responses of policymakers, and reflect it in prices. But the prices reflect noise along with the information, and they are subject to excessive swings from trend-following market participants.

Just how excessive those price swings can be was demonstrated when the 30-year bond rate was pushed down to $5\frac{1}{4}$ percent last fall, only months before being pulled up to $7\frac{1}{4}$ percent this spring. One common explanation for the increase in rates is that the market was anticipating substantially faster inflation. But nothing had transpired that would add 2 points to long-term inflation prospects. A much better explanation is that the bond market correctly saw that the expansion was picking up speed. That justified some increase in long-term rates, but hardly a rise of 2 percentage points. To explain that, we have to recognize the speculative character of today's market for bonds and related securities.

The change to a more speculative market began in the late 1970s when financial futures markets became important. It accelerated as derivative instruments related to bonds and mortgage-backed securities were developed and began to be used in huge volumes by a broad range of market participants.

A favorable economic environment helps explain their great popularity. A recession, followed by a weak start to the recovery, followed by a successful attack on the

budget deficit by the new president and Congress, all accompanied by a continual slowing in inflation rates, had led the Fed to reduce the funds rate from 9 percent to 3 percent and to keep it there from mid-1992 until this winter. Under these circumstances, market interest rates moved down steadily, and borrowing at short-term rates to buy long-term bonds became a very profitable speculation.

Emboldened and lulled by all this, many speculators, along with firms and investors who were apparently unaware that they had put themselves into speculative positions with the new derivatives, were surprised when rates finally turned up, leading to losses rather than easy gains. And because so many participants were going with the previous trend, attempts to undo their positions resulted in unusually steep price declines in bonds and related financial assets.

The main moral for monetary policy is that markets will fluctuate, often in unpredictable ways, and the Fed must rely on its own analysis of economic prospects in setting economic policy. As markets now react to the Fed's new stance, especially to its indication that current economic conditions call for no further tightening, long-term rates on bonds and mortgages may move down from their recent high levels, though certainly not to their levels before the Fed started tightening. ■

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Small Business Versus Doctors

BY JOE WHITE



The job of a politics watcher is to explain what politicians are up to. Sometimes the best we can do is identify a puzzle. Consider the treatment of small business and physicians in the health care financing battle.

Neither group is a natural supporter of universal and affordable health insurance. Small business organizations oppose any requirement that businesses contribute to employees' health insurance. Physicians suspect that cost control for the rest of us means lower incomes for them. Both are powerful interests, particularly in the small-town-dominated districts and states of pivotal moderate-to-conservative Democrats, who are most undecided about reforms.

But far greater effort has gone to satisfying small businesses than doctors. Throughout the winter and spring, continual efforts were made in Congress to lighten the Clinton plan's requirements on small employers (however defined). All were derided as insufficient.

In fact, the initial Clinton proposal provided greater proportional subsidies to small and low-wage employers than even the substantial subsidies in other countries with employment-based universal health insurance. But small business organizations object to the principle, not the details. They believe that if the government offers a good deal now, it will renege later. They believe that accepting any mandate now makes opposing other, potentially worse ones, harder. Small entrepreneurs believe that they fend for themselves—so their employees should too.

Organized small businesses are more negative than others—but organization is what matters in politics. So there was never any prospect of blunting small business opposi-

tion. The only plausible strategy was to give legislators some protection. They needed to be able to claim they “did their best” and extracted concessions. If the administration had taken a tougher stance in its bill, legislators could claim to have helped by “forcing” the president to accept something more like his actual plan. Conceding early just forced representatives to demand more—without gaining anything.

Any special breaks granted small business must be paid for—by a smaller benefit package or higher payments by someone else or more stringent cost controls. So the ever-larger breaks not only failed to buy support from small business, but will almost certainly cost the administration support from groups thus adversely affected. Puzzling.

Doctors are another story. They would prefer to do without cost controls. They dislike both obvious alternatives: regulation of fees and managed care.

Philosophically, however, physicians are ambivalent on health financing reform. Universal coverage would provide some compensation for cost controls in the form of more business. Doctors naturally believe that providing health care is one of the most important things any society can do.

Further, many physicians and their leaders believe that *not* reforming health care financing could make a bad situation even worse. Especially they fear the proliferation of managed care plans that pay managers to limit payments to physicians and that threaten not merely to limit fees but to drive doctors out of business.

Physicians do share many values with small businessmen. Many doctors basically run small businesses. But there is much more room for compro-

mise with doctors. Major physician organizations such as the American College of Physicians have endorsed the goals of reform. No comparable force exists within the small business community.

Reformers should be trying to turn this limited and potential support into really useful support—which means more support at the grassroots and a more positive attitude from the physician group that matters most: the American Medical Association. Instead, the Clinton administration's proposal offered a combination of *both* kinds of cost control that physicians dislike—more managed care and more regulation. The proposal might indeed produce a reasonable balance, but since the administration has made no argument about how it would work, physicians suspect the worst.

Somebody in Congress should be negotiating with the doctors to create a cost control system they would consider less obnoxious than either the status quo or current proposals. I can suggest some principles: managed care, instead of being encouraged, should be heavily restricted. Controls should be designed to favor physicians over administrators. Where regulation is necessary, doctors should be involved as heavily as possible—for example, in developing a national version of Medicare's Resource-Based Relative Value Scale to determine relative fees.

Getting agreement would be hard—but not as hard as satisfying small business groups. It also would be good policy: any health care system needs physicians' cooperation if it is to work well.

Bargaining with small employers rather than physicians is bad policy and bad politics. Is isn't even fair.

Can somebody please explain? ■

Joe White is a research associate in the Brookings Governmental Studies program and the author of Competing Solutions:

American Health Care Proposals and International Experience (Brookings, 1994).

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